AGA

Basel Committee on Banking Supervision

Paris, 17 March 2016

AFG comments on

Identification and measurement of step-in risk

General comments

The Association Française de la Gestion financière (AFG)[1] is grateful for the opportunity given to comment on BCBS's consultation on Identification and measurement of step-in risk.

Our association represents French asset managers whose activities are stricly regulated by European and local laws (directives, regulations, etc) and we are worried by the risk of rule duplication as asset management activities may be wrongly captured by the step-in risk framework.

A key feature to be taken into consideration when assessing any prossible framework for step-in risk is the fact that asset managers act as agents for clients that pay them to run their money according to the risk/return profile they agree upon. This means there is no risk on the balance sheet of the asset manager. Also, main links with banking entities are contractual ones and from this perspective, it makes no difference to contract with an entity of the same group or not. The probability of occurence of such a risk with our type of business is very tiny and meaningful situations that can be identified very scarce.
We advocate strongly that asset management is not a case for step-in risk.

[1] The Association Française de la Gestion financière (AFG) represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. 600 management companies are based in France. AFG members manage 3,000 billion euros, making the Paris fund industry a leader in Europe for the financial management of collective investments (with 1,500 billion euros managed from France, i.e. 19% of all EU assets managed in the form of investment funds). In the field of collective investment, our industry includes – beside UCITS – the whole range of AIFs, such as: employee savings schemes, regulated hedge funds/funds of hedge funds, private equity funds, real estate funds and socially responsible investment funds. AFG is an active member of the European Fund and Asset Management Association (EFAMA) and of PensionsEurope. AFG is also an active member of the International Investment Funds Association (IIFA).

Q1. What are commenters' views on the four overarching principles? Are there any others that should be included?

AFG believes that taking into account the probability of a step-in risk is of utmost importance in order to build an effective framework. Thus, starting theoretically from the situation after a step-in without taking into account its likelihood is much too broad and it implies that entities have no power to resist stepping-in, which is very far from reality. Indeed, stepping in is very exceptional and voluntary in nature. The rule for banks and financial institutions is to follow contractual agreements and the incentive to step-in is less and less appropriate and probable given recent evolutions in regulation and relations between actors. Thus we believe that the possibility of a bank parent stepping-in to support a non-consolidated entity has an extremely low probability of occurrence and thus remains purely largely theoretical.

There is one way to upgrade the predictability of the occurrence of such a support by simply banning it. Indeed, our members agree that a total ban on sponsor support (as for instance it is already requested in the European Parliament's version of the proposal for a Regulation of Money Market Funds) could be an effective measure to eradicate any step-in risk linked to a hypothetical implicit guarantee wrongly perceived by inventors. If we take this precise historical example of Money Market Funds (MMFs), it should be recalled that implicit guarantee on CNAV funds was not the most appropriate message to address to investors, especially in the context of possible investor runs on that type of fund that could have triggered in some cases the need for a support. It should be recalled that MMFs are investment funds and as any other type of funds (as UCITS or AIFs), the investment risk lies with the client and the message sent to the client should be clear, ie with no room for an implicit guarantee. Conversely, assuming, as investors would, that a group parent bank is provisioning to shore-up losses from non-consolidated entities in addition to the already consolidated ones has very far-reaching implications by de facto altering a product's risk profile and distorting the market.

We believe that when in the past stepping-in occurred, it was done in the context of a voluntary action with a view to better protecting long term interest both for asset managers and their clients. Contrary to the final sentence under principle 1, we judge that it is of foremost importance to differentiate in any case between temporary liquidity support and structural solvency support. We fear that an undifferentiated approach could lead to disastrous uneconomical results. We suggest that BCBS further assess the different steps in a step-in process in order to build a proportionate approach properly calibrated at each step.

Proportionality should be an independent principle. We suggest that BCBS explicitly refers to non-prudential regulations whose effect is heavily important in mitigating any risk for banks to step-in. In other words, asset management is not an activity where the risk of step-in is significant and it is through the principle of proportionality that the impact of regulations specific to this activity could effectively be taken on board.

Q2. What are commenters' views on the proposed indicators for step-in risk? Are there any additional ones that the Committee should consider?

Our members strongly advocate that the concept of sponsorship is evidently not relevant in the case of asset management. The concept of sponsorship used in the context of securitization is meaningful. The extension of the concept to the asset management industry is not appropriate: there is no originator and, in turn, no sponsor. As a consequence, such a framework cannot adequately assess the case of asset management and would wrongly bear the risk to capture our business by default and lack of proper analysis.

For clarification, at the level of the firm (the asset manager), there is no step-in risk. Asset managers do not take financial risk on their balance sheet, which is by definition a substantial feature that disqualifies the reason for any step-in risk. In addition, asset managers are authorised and supervised entities.

Regarding funds, the regulatory framework applicable to them imposes a huge amount of constraints (such as rules on concentration, liquidity, leverage, risk management, etc) as well as clear communication in terms of who bears the risk, what are the redemption policies and type of contractual guarantees (if any) as well as the absence of any implicit capital guarantee .

All the three elements listed in §46 of the consultation are good criteria that permit to demonstrate that asset management is not concerned.

First, decision making in the management of clients' portfolio is totally independent from the management of the asset manager and its parent company. The investment decisions are exclusively based on the best interests of the clients as a result of the fiduciary duty an asset manager owes to its client investors. Strong procedures to prevent conflicts of interests are in place and controls are regularly conducted by the compliance teams and the risk controllers within the firm. Furthermore, there is no capital link between the asset manager and the fund it manages, the money comes from clients and the power to decide investments is in the hands of the asset manager within the framework of a strictly regulated organization. It should be reminded that in reality the structure of the Board is not an indicator of effective power in the management of clients' money.

Second, relative to placing securities to the public, asset managers may use different distribution channels for their funds with no risk of step-in.

Regarding the financial support, there is no room for a step-in risk either. Funds may have guarantees on the capital or on the formula (structured funds) which are formal guarantees for both sides of the deal (with no necessity that the guarantor and the manager be part of the same group). Regarding the provision of liquidity facilities, the regulation limits the possibility of borrowing of a UCITS fund for instance to 10% of the NAV on a temporary basis. The borrowing capacity is secured with entities which may or may not be part of the same group. These are contractual agreements which leave no ambiguity on the lack of any risk of step-in.

Given current regulatory fight against CRA ratings overreliance, our members believe that CRA ratings cannot represent a primary indicator of step-in risk.

We do not agree with an approach where the primary indicators are not flexible for interpretation. For instance, considering an insubstantial indicator where there is no difference whether the presumed sponsor has or has no decision making power, offers total or partial upfront facilities and is or is not majority or only provider of facilities is not appropriate because it captures situations with no risk of step-in and that in addition are impossible to evidence as there is no explicit risk to mitigate.

Q3. What are commenters' views on the proposed secondary indicators for step-in risk? Are there any additional ones that the Committee should consider? Should any of them be considered as primary indicators?

AFG believes that a case by case analysis may be more effective than a multitude of thinly relevant secondary indicators. Regarding asset managers, many of the secondary indicators mentioned are not appropriate. Furthermore, with respect to our business and legal framework, some indicators appear seriously flawed in our view and should be deleted. It is the case of (h) - (inadequate information is a breach of rules governing our industry and are already dealt with in the current regulatory framework applicable to us), (j) - (investors are informed of the risk profile of the investment fund and go through appropriateness and suitability tests under MIFID before investing) and (k) - (investors bear the risk in funds they invest in, including the liquidity risk ; they are informed clearly on redemption clauses and liquidity tools that may be used by the manager are clearly disclosed in the funds' documents).

Q4. What are commenters' views on the different potential step-in risk assessment approaches? Are there any other approaches that the Committee should consider to account for step-in risks?

Asset management entities and funds do not represent a case for step-in risk. We thus acknowledge that neither the consolidation approaches, nor the conversion one are of interest.

Q5. What are commenters' views on the proposed mapping between the primary indicators and the potential approaches?

No particular comment.

Q6. What are commenters' views on proportionate consolidation for joint-ventures?

No particular comment.

Q7. What are commenters' views on risks stemming from banks' relationships with asset management activities and funds and the appropriateness of the direction envisaged?

Asset management activities and funds are highly regulated activities and we agree with the BCBS that the objective is not to duplicate existing rules. The asset management industry rightly has specific rules. It would be detrimental to suppose that the same types of rules as for banks could be applied, except of course for those activities usually conducted by banks.

Asset management industry follows an agency model with no financial risks taken on its balance sheet.

Our members believe that the concept of supporting an unconsolidated asset management company or funds (both for credit enhancement and provision of liquidity) is highly improbable.

We agree that prudential regulation should cover activities such as granting of capital/formula guarantees. In France, this is the case in our domestic regulation where only banks (as prudential regulated entities) are entitled to grant guarantees. Formal bank guarantees do not constitute a step-in risk situation.

Banking entities may be counterparties to funds, but this situation is a contractual relation and in addition fully covered by regulation (conflicts of interest, best selection and best execution...). Besides, asset managers have multiple counterparties and there is no difference between treating with an entity of the same group or an entity with no other link. Borrowing is limited, for instance UCITS funds cannot borrow unless it is temporary in nature and represents less than 10% of the NAV.

Regarding money market funds (MMFs), the implicit support that could have been perceived by investors in CNAV structures is a very specific feature. This feature is not present for the vast majority of funds where the valuation rules are much more marked to market so as it the investor who bears the risks of the investment he made. It should be thus clarified that the historical example of CNAV MMFs sold as deposit-like instruments and even used in US as a means of payment is a circumscribed and identified (by regulators worldwide) example and should not be used to capture funds or asset managers in general. A positive step is acknowledged in the European Parliament's version of the proposal for a European regulation on MMFs by the ban of any support by the promoter. Either as a consequence of the application of this Regulation or a self industry engagement to ban support, it is highly probable that there would not be any residual step-in risk on behalf of MMFs.