ASSET MANAGEMENT AND INVESTORS COUNCIL

ICMA AMIC response – European Commission Consultation Document: Review of the EU Macro-Prudential policy framework

Introductory comments – macro-prudential policy for non-banking institutions

The ICMA[1] Asset Management and Investors Council ('AMIC') was established in March 2008 to represent the buy-side members of the ICMA membership. ICMA is one of the few trade associations with a European focus and both buy-side and sell-side representation. AMIC welcomes the opportunity to respond to this consultation by the European Commission on the review of the EU Macro-Prudential Policy Framework.

AMIC welcomes the focus on macro-prudential policy by the European Commission, but if the role and powers of the ESRB are revised then a different approach should be pursued. As a buy-side representative body, AMIC will focus the questions that deal with macro-prudential policy regarding non-banks only.

We would like to make some preliminary comments about non-banking macro-prudential policy that frame our answers to some of the questions in your consultation paper.

Although we welcome the consultation's intent, we would caution the Commission from considering the expansion of the European Systemic Risk Board's (ESRB) mandate beyond banking without careful consideration of the structure of the ESRB. A rapid expansion of the ESRB's mandate and powers could lead to inappropriate risk selection and understanding of non-banks and risks related to financial markets. An expansion of risk analysis and recommendations to non-banking without sufficient time to understand better the wider investment sectors could be damaging to the economy and to investors.

If regulators and supervisors want to tackle the risks involved in non-banking, especially asset managers, we believe that they should more widely tackle the risks involved in financial market activities. Such a holistic approach to market-wide risks should involve assessing the market impact of the activities of all market participants whatever their profile – systemic risk is not necessarily proportionate to the size or profile of market participants. It is from this perspective that we believe the review of EU macro-prudential policy is an opportunity to move away from banking-biased thinking about systemic risk.

We agree with the European Commission that the current exchange and understanding of data among authorities is insufficient at a European level. We agree that improving the sharing of current market data is warranted, as we believe this will lead to a better and more nuanced understanding of risk outside the banking system in Europe. However, before asking market participants to report new types of data, regulators and supervisors should first better transmit, aggregate and use among themselves, at national and European levels, all the data already reported to them through various existing legislative requirements (e.g. UCITS, AIFMD, MiFID, EMIR, SFTR) and from this basis assess the need or not for requiring additional data from market participants.

[1] International Capital Market Association (ICMA) – Transparency Registry Number 0223480577-59

If the macro-prudential role of the ESRB is to be extended to non-banking, it is important that the ESRB in its governance recognises a parity of power between the EBA, ESMA and EIOPA and in its staffing ensures a parity of staff and skills between banking specialists, financial market specialists and insurance specialists.

More broadly we recommend that the European Commission proceeds cautiously in this area. Macro-prudential policy, both in the banking and non-banking sectors, is still in its infancy and largely untested as a financial risk management tool. We believe there is still a lack of clarity over the purpose of macro-prudential policy. It is unclear whether it is designed to prevent systemic risk or whether it is designed to act as a monetary policy tool to withdraw momentum from an overheated market or to add stimulus to a slowing market.

We would also like to make some remarks about asset management specifically, where we believe the following three observations are important:

- Asset management companies act as agents on behalf of end investors. Generally, risks are borne by end investors and are not included on the balance sheets of asset managers.

- Second, the activity of asset managers is to manage assets and not to provide credit, as opposed to banks.

- Third, among the investment decisions taken by investors in financial markets, and as noted by the Financial Stability Board (FSB)[2], only a minor part – between 22% and one third of the total investments in capital markets – is passed through asset managers. The remaining assets are directly managed by the investors or asset owners without delegation to independent asset managers.

Therefore, we believe the priority of regulators' efforts, when considering asset management is to concentrate on surveying the activities and investment decisions of all parts of the investment world instead of focusing exclusively on third party asset managers. We would prefer a holistic, market-wide approach.

We have already been active in the global debate on the possible systemic risk related to asset managers. AMIC has responded to three FSB/IOSCO consultations on the topic, in 2014, 2015 and 2016. On 7 April 2014 the AMIC responded to the FSB/IOSCO consultation on the assessment methodologies for identifying non-bank non-insurer Global Systematically Important Financial Institutions ('NBNI G-SIFIs').

On 29 May 2015, AMIC responded to the second FSB/IOSCO consultation on a methodology to identify NBNI G-SIFIs. AMIC welcomed the FSB/IOSCO's willingness to refine its approach following the first consultation, but cautioned against including asset management companies as potentially systemically risky entities alongside investment funds.

On 21 September 2016, AMIC wrote a response, available here, to the consultation by the FSB on proposed policy recommendations to address structural vulnerabilities from asset management activities, led by the AMIC Fund Liquidity Working Group. The working group was set up in 2015 to draft, in cooperation with the European Fund and Asset Management Association (EFAMA), a

[2] FSB Consultative Document: Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities, page 7

research report on liquidity risk management in investment funds. AMIC strongly welcomed the approach by the FSB to focus on the activities of asset managers rather than designating individual companies as systemically important, although it was our view that some of the proposed FSB Recommendations required amendments.

We look forward to working with the European Commission in its subsequent deliberations on this topic and the review of the role and powers of the ESRB.

Questions:

Q1: Do you consider the degree of coordination between the different authorities in the current framework (i.e. ESRB, national macro-prudential authorities, Commission, Council, etc.) appropriate? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all), and explain your scoring.]

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We are concerned at the imbalance in the governance of the ESRB which leads to a "5" grade.

In the current governance of the ESRB (reflected in Annex 2 of this consultation paper):

- half of the ESRB Steering Committee members are representing the ECB and national central banks; and
- among the 38 voting members of the ESRB General Board, 30 members are representatives of the ECB and national central banks.

Also, in the staffing of the ESRB there is no equal balance between banking experts, securities experts and insurance experts, therefore not ensuring an equal balance in experience and expertise between the three areas.

This imbalance should be addressed before any expansion of macro-prudential policy beyond banking is considered.

Regarding data, we believe there is a need for improved sharing and use among authorities of the data currently reported by market participants, in particular in order to improve coordination among authorities. Asset managers already report a rich amount of data to their national competent authorities, much of it set down in AIFMD and UCITS[3], and more widely market participants report data in relation to EMIR and SFTR for instance. We recommend, in line with our fund liquidity risk management report that the data currently reported should be better used (and their need assessed) for macro-prudential risk analysis by the ESMA and ESRB – before requiring any provision of additional data from market participants.[4]

Q2: (a) Would you consider appropriate to expand the macro-prudential framework beyond banking? [Please rank your answer from 1 (fully appropriate) to 5 (fully inappropriate), and explain your scoring.] (b) If deemed appropriate, what kind of systemic risks should be targeted and how?

Q2(a): 5

We would caution the Commission from considering the expansion of the ESRB's mandate beyond banking without revising the structure of macro-prudential policy. The danger with continuing the current set up is that the ESRB continues to view every facet of risk through a banking lens, without sufficiently considering specificities of other sectors in the financial sphere.

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[3] AMIC and EFAMA report: Managing fund liquidity risk in Europe, April 2016 http://www.icmagroup.org/News/news-in-brief/new-fund-liquidity-report-from-efama-and-icma-outlines-tools-available-to-manage-liquidity-risk/ pages 8 and 14

[4] Ibid. page 20

For example, the funding model and asset investment policies are very different in investment funds, pension funds or insurers as compared to banks.

A rapid expansion of the ESRB's mandate and powers could lead to inappropriate risk selection and understanding. An expansion of risk analysis and recommendations to non-banking without sufficient time to understand better the wider investment sectors could be damaging to the economy and to investors.

The European Commission should recognise that macro-prudential policy, both in banking sector and beyond, is in its infancy and its efficacy is largely untested. The objective of macro-prudential tools and how they would be used still lacks definition and is often blurred with the objectives of monetary policy (i.e. it is unclear to us if macro-prudential policy is about financial stability or to control the credit cycle). This needs to be clarified before any extension of such tools and the objectives of monetary policy and of macro-prudential supervision should be better synchronised. I.e. if quantitative easing (QE) has brought about abnormal market conditions, a heavy-handed application of macro-prudential policy tools (especially those that are bank-like) to non-banks risks would repress investor activity.

The key issue is that the prudential risk related to markets is by nature very different from the prudential risk related to banks: the risks related to markets should be assessed based on the market impact. Market finance is very different from banking finance by nature and therefore needs a different mindset to understand risks involved and develop policies to counteract this. The tools to achieve the same macro-prudential goal need to be tailored to the related risks – i.e. applying the same tool to different business models will not lead to equivalent outcomes. We believe that securities regulators have expertise and experience and are therefore best placed to work on such issues from a market-wide perspective.

We recommend ESRB's mandate and powers are not expanded until the role of securities regulators and ESMA is better understood and integrated into the work of the ESRB. In this regard, we would particularly like to refer to Articles 22-24 of the ESMA founding regulation (Regulation 1095/2010), which explicitly gives a role to ESMA to identify systemic risk and to have the capacity to respond to them as well. AIFMD also gives explicit powers to securities regulators to limit leverage in order to ensure the stability and integrity of the financial system in Article 25(3). Therefore, it is disappointing that the governance structure of the ESRB does not reflect this role given to securities regulators and ESMA in the area of market-based systemic risk – indeed apart from the Chairperson of ESMA, securities regulators have no voting rights on the General Board of the ESRB.

Therefore, expanding the ESRB's powers to hypothetically apply bank-like tools like mandatory haircuts on securities financing instruments, or cash buffers for non-bank actors, is not appropriate under the current framework.

Q2(b): Regarding how any potential non-bank measures should be targeted, we recommend survey based analysis, sharing from ESMA and securities regulators, and if appropriate, the sharing of results of fund-level stress tests with the ESMA/ESRB. Improving the use and analysis of the data currently reported by market participants is very important before any new additional measures are considered.

Q29: Do you think that the ESRB's mandate and tasks are appropriately formulated to ensure efficient coordination of macro-prudential policies in the EU? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all).] If not deemed fully appropriate, what changes would you suggest to ensure such efficient coordination?

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We do not believe the ESRB's mandate and tasks are appropriately formulated currently, owing to the dominance of banking supervisors in the voting membership of the Board, structure and staffing of the ESRB, as outlined in our response to Question 2(a).

Q30: How do you assess the current capacities of the ESRB to deliver on its mandate for conducting system-wide risk analysis, including its access to relevant data? [Please rank your answer from 1 (fully adequate) to 5 (not adequate), and explain your scoring.]

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As we have outlined in response to Questions 1 and 2, the ESRB is not currently well suited to deliver on its mandate for conducting system-wide risk analysis due to the heavy dominance of banking supervisors in the voting membership of the board, structure and staffing of the ESRB.

Furthermore, the analysis given by the European Commission in this consultation document is incomplete. It is true that market-based financing outside the banking sectors is growing in importance. But the fact that market-based financing is growing in relation to banking financing is not reason enough to adopt the same approach to systemic risks.

In addition, among market participants, and as we have noted in our introductory comments, in market-based financing third party asset managers only manage less than one-third of the total financial assets of institutional investors. The remaining assets are managed by the investor or asset owner without delegation to independent asset managers.

Moreover, the percentage of assets managed by third party asset managers relative to total financial assets including those managed internally by institutional investors is decreasing, having fallen from 25% in 2007 to 22% in 2011. So, the current trend for financing the real economy is not only one of "banking disintermediation" for financing the real economy, but also now an "asset manager disintermediation": investors ("asset owners") are increasingly directly investing and managing assets in the financial markets.

We therefore agree to revise the profile of the ESRB staff, but in the view of making use of the skills of professionals coming from securities regulators – in addition to revising the ESRB Governance more broadly (see above).

Conversely, we are concerned about the European Commission's suggestion of "*keeping the strong link between the ESRB and the central bank community, notably the ECB*": the day-to-day experience of financial markets is key, and securities regulators are better placed here.

Q31: In particular, do you consider that the resources of the ESRB Secretariat are adequate in this context? [Please rank your answer from 1 (fully adequate) to 5 (not adequate), and explain your scoring.]

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The focus is not necessarily the number of personnel that the ESRB has at its disposal, but the profile and skills of the staff, which we believe should better reflect securities regulators.

Q32: What do you consider to be the best ways to ensure that the macro-prudential perspective is sufficiently reflected in EU policy making where systemic risk considerations are involved?

The governance of the ESRB should ensure equal powers between banking supervisors, securities regulators and insurance supervisors. This is where the holistic approach of the financial markets, across the whole range of market participants, that we outline in our preliminary comments, is important, and would ensure better policy making in the EU for market-wide risk issues.

Q33: How do you assess the instruments and powers of the ESRB? In particular, do you see the need for the ESRB's powers to explicitly include 'soft power' tools with a view to fulfil its mandate?

We agree with the Commission's view that the current powers and instruments of the ESRB are sometimes overly formal and bureaucratic. Therefore, we agree that "soft" powers such as informal dialogue should be incorporated into the routine of the ESRB.

This could have the significant upside of allowing the ESRB staff to gain a much better understanding of risks in the non-banking sector, where we believe there is significant potential for such a better understanding compared to the current situation.

Q35: Would you consider the two-tier managerial structure along the lines proposed above an appropriate way to improve the governance structure of the ESRB? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

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Given our concerns about the current imbalanced governance structure of the ESRB, the proposed two-tier governance structure in the consultation paper could risk embedding the current weaknesses. So, while it is possible that a two-tier approach might streamline decision making, it should not be used as a tool for banking supervisors to remain the sole or dominant representatives of Member States in debates on non-banking issues. Therefore, we remain concerned about the idea to reduce the number of General Board members.

However, we agree that a flexible approach could be better, as it should allow representation in the meetings to be tailored to the topic being discussed. However, on non-banking issues it is essential that the representative from a Member State should be from the supervisory authority responsible for financial markets, and that representative should have voting power.

Q36: How does the current size of the General Board affect the exchange of confidential and sensitive information and smooth decision making? Do you see merit in reducing its size and/or shifting some of its tasks to the Steering Committee? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

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We do not have a strong view on the size of the General Board as it relates to confidentiality of sensitive information.

However, regarding smooth decision making, the consultation paper's proposal to reduce the size of the board could lead to even greater concentration of power with banking supervisors as opposed to securities regulators if the composition of the board is not balanced across the three financial sectors. The focus should not be the size of the board but of equal balance among the three sectors, and in particular we believe that securities regulators should be given a stronger binding voice on the board of the ESRB.

Q37: (a) How do you suggest accommodating the establishment of macro-prudential authorities at the national level, and the SSM and SRB, in the General Board's membership? (b) Do you consider it warranted to require Member States to designate a single national representative, with representation possibly varying in accordance with the concrete issues for discussion and decision? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

Q37 (a): If macro-prudential authorities can reflect the expertise and experience of securities regulators then their presence on the General Board should be welcomed. However, accommodating macro-prudential authorities from both national and SSM/SRB level on the General Board should not lead to further entrenching of the central bank and bank supervisor voice.

Q37 (b): 2
We agree that a flexible approach could be better than the current approach, as it should allow representation in the meetings to be tailored to the topic being discussed. However, on non-banking issues it is essential that the representative from a Member State should be from the supervisory authority responsible for financial markets, and that representative should have voting power.

Q38: How do you assess the work of the two ESRB advisory committees (ATC and ASC)? In particular, would you suggest any changes in their role and/or composition?

We believe that the two advisory committees could play a more prominent role in helping the ESRB better understand the non-banking financial markets.

ENDS