International
Capital
Market
Association

ICMA

ASSET MANAGEMENT AND INVESTORS COUNCIL

Secretariat of the Financial Stability Board
C/o Bank for International Settlements
Basel
CH-4002
Switzerland

London, April 7, 2014

Dear Sirs,

Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systematically Important Financial Institutions

The ICMA 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 having both buy-side and sell-side representation.

The AMIC composition embraces the diversification and the current dynamics of the industry – representing the full array of buy side interests both by type and geography. The AMIC's focus is on issues which are of concerned to its broad membership, rather than having a specific product focus.

The AMIC welcomes the opportunity to respond to the FSB/IOSCO consultation on the assessment methodologies for identifying non-bank non-insurer Global Systematically Important Financial Institutions ('NBNI G-SIFIs') and wishes to stress the following key points.

1. The AMIC supports targeted and proportionate measure designed to strengthen regulation and thus make the global financial system more stable.
2. Identification of NBNI G-SIFIs should recognise how they differ from bank and insurers SIFIs; typically asset managers have a very small balance sheet and hold assets of their clients and exercise fiduciary duties.
3. Size is one filter amongst others to be considered in the process of identification of the systemic risk of NBNI G-SIFIs.
4. The definition of GNE is not appropriate for assessing "size" since it is not an accurate or consistent measure of exposure, particular with respect to derivatives positions. International exposure should be considered as a factor of diversification that overall reduces risk.
5. Following the FSB/IOSCO proposal to proceed with an entity-focused methodology, appropriate levels of scrutiny are individual investment funds rather than asset managers.
6. A harmonised international implementation is the only way to prevent any local interpretation in the identification of NBNI SIFIs;

7. AMIC members note that unfortunately the consultation paper does not describe any policy that might apply to NBNI SIFIs that would be identified through the methodology.

Specific comments

In addition to the general points presented above, the AMIC is presenting its detailed views in its answers to the relevant questions raised in the consultation paper.

Q1-1. In your view, are the three transmission channels identified above most likely to be the ones transmitting financial distress of an NBNI financial entity to other financial firms and markets? Are there additional channels that need to be considered?

AMIC members believe that, as far as asset management is concerned, the counterparty (exposure) channel and the market (liquidation) channel are the relevant risk transmission channels to evaluate.

Funds are key actors in the capital market and may represent an important portion of the transactions on a segment and may be in a position to create price movements, notably but not exclusively if forced to sell to face redemptions. However this risk is borne by the end-investor as asset managers do not act as principals and as such act as systemic "shock absorbers," diffusing rather than amplifying risk.

The fund can be exposed to selected OTC counterparties, where market structure so determines. Yet, the new robust regulatory regime for OTC transactions, the standard practice of posting initial margin and exchanging variation margin and the stringent selection procedures limit the possibility of counterparty risk transmission.

AMIC members do not agree with the fact that funds would transmit financial instability through the third channel, substitutability. Investors can redeem their investment in a fund they are not satisfied with at any time. Investment funds – by the nature of their business – are highly substitutable, and new funds open and existing funds wind down regularly with no systemic impact.

Moreover these channels were identified when analyzing the banking industry – and it must be expected that certain channels are less relevant for the asset management industry.

Q2-1. Does the high-level framework for identifying NBNI G-SIFIs (including the five basic impact factors) adequately capture how failure of NBNI financial entities could cause significant disruption to the wider financial system and economic activity? Are there any other impact factors that should be considered in addition to those currently proposed or should any of them be removed? If so, why?

The five basic impact factors are not an equal footing when it comes to provide an overview of a measure of potential systemic risk and therefore should be organised in a clear hierarchy.

Three criteria should be considered: leverage, interconnectedness and size. Leverage relates to the connection with the banking system; and in the same vein interconnectedness – an indicator of the scale of the NBNI G-SIFIs involvement with different counterparties - will be relevant. Size, that will exempt many entities that should not be concerned by the potential NBNI SIFIs policy outcome, should be considered in connection with leverage – as two entities of the same size can present widely varying risk profiles depending, for example of their use of leverage.

International presence, substitutability and complexity are secondary and should not be taken into account in the assessment of systemic risk, unless the above-mentioned criteria are met by a potential NBNI G-SIFIs.

Q2-2. Is the initial focus on (i) finance companies, (ii) market intermediaries, and (iii) investment funds in developing sector-specific methodologies appropriate? Are there other NBNI financial entity types that the FSB should focus on? If so, why?

AMIC members disagree with the fact that investment funds are considered as one type of entities and believe that diversity exists within the universe of 'investment funds' and should be recognised. For example, FSB pointed in its November 2013 report on Market Finance that equity funds do not present systemic risk when Hedge Funds have from the start been identified as potentially risky.

In addition attention should be given to the supervision and regulation of market infrastructures especially CCPs and CSDs. Following recent regulatory reforms, they hold an even more central position in market transactions.

Q3-1. Is the proposed scope of assessment outlined above appropriate for operationalising the high-level framework for identifying NBNI G-SIFIs? Are there any practical difficulties associated with the proposed scope of assessment?

AMIC members believe in a proposal that presents a robust, measurable or objective process, and avoid any emphasis on individual indicators and measures, and which recognises the idiosyncratic characteristics of the asset management industry. Moreover, the FSB analysis is concentrated on failure or distress. This may occur in a market or a bank but will be very rare in a fund.

Q3-2. In your view, are the above proposed materiality thresholds (including the level) for the NBNI financial entity types appropriate for providing an initial filter of the NBNI financial universe and limiting the pool of firms for which more detailed data will be collected and to which the sector-specific methodology will be applied? If not, please provide alternative proposals for a more appropriate initial filter (with quantitative data to back-up such proposals).

As noted in Q 2-1, three criteria should be considered: leverage, interconnectedness and size. Leverage relates to the connection with the banking system; and in the same vein interconnectedness – an indicator of the scale of the NBNI G-SIFIs involvement with different counterparties - will be relevant. Size, that will exempt many entities that should not be concerned by the potential NBNI SIFIs policy outcome, should be considered in connection with leverage – as two entities of the same size can present widely varying risk profiles depending, for example of their use of leverage.

Q3-3. Are there any practical difficulties in applying the materiality thresholds?

Please refer to our response in Q2-1

Q3-4. In your view, what is the appropriate threshold level, taking into account the range given above (USD 400-600 billion in GNE), for hedge funds? Please also provide reasons with data to back it up.

AMIC members do not have a specific view, but would like to refer to the other existing regulatory framework that should be considered in order to ensure consistency across the board. Firstly, the European AIFM Directive which introduced the category of AIFs using a substantial leverage, defined as more than 3 in exposure when there is 1 in capital. Secondly, it seems that much higher levels of leverage are being contemplated for the banking world (under the emerging leverage ratio). Therefore AMIC members believe more analysis should be done to assess the optimal level of leverage in the system as a whole, as well as in its component parts. Please refer to our point raised on the definition of GNE made in q6-7.

Q3-5. Do you think that it would be beneficial to set additional materiality thresholds based on "global activity"? If so, please explain the possible indicator and the level on which materiality thresholds should be set (with reasons for selecting such indicator, the level and any practical challenges).

AMIC members believe that global activity should not be seen as a relevant indicator as global activity helps diversification and therefore reduces risk.

Q6-1. In your view, does the proposed definition of investment funds provide a practical basis for applying the specific methodology (i.e. indicators) to assess the systemic importance of NBNI financial entities that fall under the definition?

In general, the definition is viewed as practical but insufficiently defined. Although some entities are clearly included, the status of others is less clear.

There are many different sorts of funds, and this should be highlighted more prominently in the consultation paper. Moreover existing or soon to be implemented local regulations should give competent authorities provide more access and data on their level of risk according to the type of funds in question.

Q6-2. Does the above description of systemic importance of asset management entities adequately capture potential systemic risks associated with their financial distress or disorderly failure at the global level?

The asset management industry presents certain characteristics which lead them to present very different risk profiles when compared to other actors in financial market – which current regulatory framework recognises.

AMIC members already discussed the transmission channels, and how they apply to the asset management industry, in Q1-1, and we would like to reiterate that substitutability should not be considered a transmission channel of systemic risk.

The AMIC agrees with the statement in the consultation paper *that 'the manager acts as an 'agent', responsible for managing the fund's assets on behalf of investors according to its investment objectives, strategy and time horizon'*. Consequently, *'investment management is characterized by the fact that fund investors are knowingly exposed to the potential gains and losses of a fund's invested portfolio'*. The risk of loss is disclosed to and accepted by investors, and any potential loss would be directly absorbed by those same investors. And therefore 'l*osses on investment by a fund could, if exposures are significant and have not been adequately managed, generate heavy losses to counterparties and ultimately destabilize creditors who might be systematically important in their own rights*' does not reflect the business of fund management.

As far as the market transmission channel is concerned, a fire sale occurs when a fund pushes prices down through heavy sale orders placed to recover liquidity, be it to meet margin requirements, risk limits or redemptions. This may cause a drop in NAV which will signal to investors that there is a problem and prompt new redemptions. Asset managers have to manage this risk with appropriate measures as part of their duty to investors, and as the consultation paper recognises: *'they are also important aspects worth considering that may dampen the global systemic impact of a fund failure. For instance, depending on national regulation, asset managers may temporarily implement specific liquidity management tools such as swing pricing, anti-dilution levies, redemption gates, side-pockets, redemptions in kind or temporary suspensions'*.

But two points have to be mentioned in order to put that risk in perspective:

- While funds may experience increased redemptions in periods of high volatility and market stress there is no historical evidence that redemptions of fund investors have induced fire sales by equity or bond funds and led to a collapse of securities prices and systemic risk.
- Existing regulations protect both the liquidity needs of investors and the stability of asset prices.

Potential systemic risks should therefore consider the parameters set by the current regulatory framework as well as take into account the idiosyncrasies of the asset management industry. As noted in Q 2-1, three criteria should be considered: leverage, interconnectedness and size. Leverage relates to the connection with the banking system; and in the same vein interconnectedness – an indicator of the scale of the NBNI G-SIFIs involvement with different counterparties - will be relevant. Size, that will exempt many entities that should not be concerned by the potential NBNI SIFIs policy outcome, should be considered in connection with leverage – as two entities of the same size can present widely varying risk profiles depending, for example of their use of leverage. Moreover AMIC members believe that global activity should not be seen as a relevant indicator as global activity helps diversification and therefore reduces risk.

Q6-3. Which of the following four levels of focus is appropriate for assessing the systemic importance of asset management entities: (i) individual investment funds; (ii) family of funds; (iii) asset managers on a stand-alone entity basis; and (iv) asset managers and their funds collectively? Please also explain the reasons why you think the chosen level of focus is more appropriate than others.

Asset managers have very small balance sheet, generally comprising operational capital and goodwill, and do not act as lender or counterparties, and have limited interconnections. The company level is by regulation required to maintain a minimum level of capital that must be protected and cannot be invested in risky assets – therefore AMIC members do not agree that level (iii) of focus is appropriate.

Any consideration of focus on particular investment funds should expressly account for factors that may distinguish among prospective G-SIFIs including the capability of management, risk controls, board oversight, diversification, liquidity options, disclosure and the relative ease of resolvability; and should consider also that control of risks functions reside at the level of the management company.

Q6-4. Should the methodology be designed to focus on whether particular activities or groups of activities pose systemic risks? If so, please explain the reason why and how such a methodology should be designed.

FSB and IOSCO have already identified activities that should be investigated and regulated to affirm financial stability, before it focused on NBNI G-SIFIs, such as securitisation, non-cleared OTC transaction, and securities financing transactions. It is important that the current discussion on NBNI G-SIFIs takes into account the findings of these important existing work streams. In addition it is key to avoid overlapping regulations.

Q6-5. Are the proposed indicators appropriate for assessing the relevant impact factors? If not, please provide alternative indicators and the reasons why such measures are more appropriate.

Please refer to our response to Q2-1, Q6-2, Q6-3 and Q6-4

Q6-6. For "cross-jurisdictional activities", should "the fund's use of service providers in other jurisdictions (e.g. custody assets with service providers in jurisdictions other than where its primary regulator is based)" be used?

AMIC members believe that international exposure should be seen as a factor of diversification that overall reduces risk, and local regulation is in place to protect foreign client's rights. Therefore the use of service providers in other jurisdictions is not a valid set of criteria to identify NBNI G-SIFIs. This aspect is relevant to distributors, counterparties or other partners or service providers of a fund or an asset manager.

Q6-7. Is the definition of "net AUM" and "GNE" appropriate for assessing the "size" (indicators 1-1 and 1-2)?

The definition of GNE is not appropriate for assessing "size" since it is not an accurate or consistent measure of exposure. In particular, with respect derivatives, gross notional values significantly overstate actual risk exposure and do not account for significant differences in the risk profiles of derivatives contracts in different asset classes or of different durations. Finally, looking at derivative gross notional values alone ignores a number of important risk mitigating practices related to derivatives, including hedging / netting, collateral / margin, and clearing.

Q6-8. Is the definition of "investment strategies" sufficiently clear for assessing the "substitutability" (indicator 3-3)?

AMIC members do not believe that the definition as stated is a workable metric, and is not sufficiently clear for the purposes of a robust or meaningful assessment.

Q6-9. Would collecting or providing any of the information included in the indicators present any practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be collected or provided instead.

Yes, not all relevant data is kept with asset managers, and will be with banks as counterparties – and therefore bank supervisors will already have them. Moreover not all the required figures are readily available in the format for the G-SIFIs assessment. The cost incurred would be large, especially for asset managers managing a large number of funds.

Any data collection requirement should be preceded by clarity of definition as expressed in our responses above.

Q6-10. Are there additional indicators that should be considered for assessing the

relevant impact factors? For example, should "the fund's dominance in a particular strategy (as measured by its percentage of net AUM as compared to the total AUM" also be considered for "substitutability"? Similarly, should "leverage" or "structure" of a fund also be considered for assessing "complexity"? Please explain the possible indicators and the reasons why they should be considered.

Please refer to our responses above.

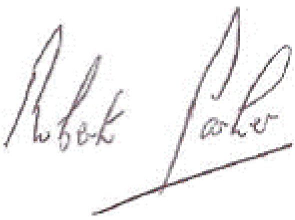
Q6-11. Should certain indicators (or impact factors) be prioritised in assessing the systemic importance of investment funds? If so, please explain which indicator(s) and the reasons for prioritisation.

Please refer to our responses above.

In the process of identifying NBNI G-SIFIs, AMIC members argue for a harmonized implementation at an international level, and should not leave too much room at the discretion of national regulators.

The AMIC would be happy to discuss further with you the points made in this letter. The Secretary of the AMIC, Nathalie Aubry-Stacey, can be reached at Nathalie.aubry-stacey@icmagroup.org should you need further information.

Yours sincerely,



Robert Parker
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