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AFG comments on FSB's
Proposed Policy Recommendations to Address Structural Vulnerabilities
from Asset Management Activities

General comments

The Association Française de la Gestion financière (AFG)[1] is grateful for the opportunity given to comment on FSB's consultative document on Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities.

We welcome the current consultation's transversal approach and we encourage the FSB to go one step further. The FSB aknowledges (on page 7 of the consultation) that current focus (third party asset managers) would cover roughly no more than one third of the total investor assets. An efficient way to deal with the development of market-based finance should strive to assess globally the market impact of players (incompassing individual investors/HNWI, sovereign wealth funds, pension funds, etc[2]).
AFG members believe that FSB rightly assesses potential structural vulnerabilities. Liquidity and leverage risks are risks that our members and regulators take very seriously in their management/internal

[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).
[2] Some recent examples were impacting: citizen Singh prosecuted by US courts for having generated the US flash crash in 2010; sovereign wealth funds financed through oil revenues are thought to have contributed to market downturns in 2015 and 2016…

rules and respectively regulatory set of rules. AFG sees little space in the European set of regulations for new requirements, such as reporting requirements, who might prove to be disruptive and counterproductive. These vulnerabilities have already been identified and tackled at European level.

AFG members totally support the FSB's undertsanding of the asset management as a stand alone sector that justify plainly its own adapted regulatory framework. Banking regulation is not applicable to asset management.

AFG's answers to specific questions asked in the consultation document

Q1. Does this consultative document adequately identify the structural vulnerabilities associated with asset management activities that may pose risks to financial stability? Are there additional structural vulnerabilities associated with asset management activities that the FSB should address? If there are any, please identify them, as well as any potential recommendations for the FSB's consideration.

AFG members believe that FSB rightly assesses potential structural vulnerabilities associated with asset management activities that might pose some risks to financial stability. Liquidity and leverage risks are risks that our members and regulators take very seriously in their management/internal rules and respectively regulatory set of rules. AFG don't see any additional structural vulnerabilities. In addition, AFG sees little space in the European set of regulations for new requirements, such as reporting requirements, which might prove to be disruptive and counterproductive.

We would like to stress two important aspects related to these potential vulnerabilities and the solutions to cope with them.

- First, these vulnerabilities have already been identified and tackled at European level. Asset management is a tightly regulated activity. Funds and managers in Europe are already subject to a number of Directives and Regulations that are very prescriptive, UCITS and AIFM Directives for instance. Liquidity and leverage risks are already dealt. AIFM reporting is very exhaustive and already in place. We would like to recall also that the AIFM Directive was explicitly initiated to tackle the potential sources of systemic risk involved in asset management non-UCITS activities;

- Second, FSB is right to raise the awareness of the fact that asset management has its own specificities that justify an own adapted regulatory framework. Banking regulation is not applicable to asset management. Asset managers are not banks, they act as agents for the investors who entrust them with their money, pay a fee and carry the risks of the investments. For instance, leverage measures in Europe have been thinly worked in UCITS and AIFM Directives so as to take into account the funds' particularities. The Basel-like (banking) leverage approach was designed for the calculation of capital requirements. The unmistakable difference in goals between the two industries accounts as a major distinction between the two frameworks. UCITS and AIFM approaches have been tested in practice with no incident.

We urge FSB to acknowledge the in depth efficient work already done in these fields by the European regulators and not to impose unnecessary changes to existing proven frameworks.

We believe pension funds and sovereign wealth funds are taking part in market activities too and that a siloed approach risks being less efficient than a holistic market-wide approach.

Our members believe that the concerns expressed by the FSB in terms of operational vulnerabilities linked to the transfer of mandates between asset management companies are not founded. Our members think that transfer of mandates are very standard decisions that imply a minimum of agreement on the terms an delays but which do not create difficulties, even in stressed market conditions.

As far as securities lending activities by asset managers are concerned, AFG strongly believes that indemnification or guarantees (if they are provided by asset managers) should be prudentially regulated in a way comparable to what applies to banks that carry that type of activities. This remark is not limited to the SFT area but should apply more generally on all activities that are traditional banking activities.

AFG would like to recall that with the exception of CNAV money market funds (CNAV MMFs) – as also noted in the introduction to the consultative document – existing regulatory requirements have proved to be resilient. CNAVs are the exception to the fund mark to market valuation rules, because they imply with the constant value that risks are not borne by investors. Classical funds (including VNAV MMFs) do not carry this run risk generated by the first mover's advantage. The CNAV exception should not be considered as representative for the asset management's classical fund structures.

Q2. Do the proposed policy recommendations in the document adequately address the structural vulnerabilities identified? Are there alternative or additional approaches to risk mitigation (including existing regulatory or other mitigants) that the FSB should consider to address financial stability risks from structural vulnerabilities associated with asset management activities? If so, please describe them and explain how they address the risks. Are they likely to be adequate in stressed market conditions and, if so, how?

Our first comment is linked to the "one size fits all" risk, which should be avoided. AFG believes that if in general these FSB's high level recommendations are wise, they fail to acknowledge sufficiently the diversity of funds and client investors. This is why, the FSB should clearly and above all promote that "one size fits all" approach is not what is intended. A proportionate and differentiated approach is the only way to ensure an effective global regulation.
Second, a gap analysis is essential on subjects contemplated by this consultation as it permits to concentrate only on those areas that may need some further regulatory attention and not pursue with either the creation of a double layer regulation or with disruptive leap-into-the-dark replacement regulation.

Third, the link between liquidity and valuation issues is of importance. When the fund displays the "right" price, there is no issue to make new liquidity in the fund by selling fund positions into the market. There is also no arbitrage issues or first mover advantage. Classical funds (non CNAV) are marked to market and permit to pass on the investor the investment risk. The CNAV exception should not be considered as representative for the asset management's classical fund structures. When funds are distributed as funds and not as deposit like instruments, investors understand that the price may move and the valuation process is established to obtain a fair price. Tools like anti-dilution levies (ADL) or swing pricing do evidence the link between valuation and liquidity concerns.

We welcome FSB's and IOSCO's positive understanding of the important and growing role of liquidity management tools, like redemption gates (deferrals), swing pricing, etc. Our members believe there is further need of assessment linked to their relative efficiency in different types of market circumstances as well as appropriateness to different types of clients. It is important to specify that these tools, in addition to benefits in terms of market stability, are protective for all investors (and especially for investors remaining in the fund). Our members further suggest that all of the 26 tools referenced in the December 2015[3] report published by IOSCO be given a definition (even if the document confesses that at least 3 of them have never been implemented) in order to develop cross discussions on best practices that could be copied in different jurisdictions.

Leverage is a risk identified since a long time in asset management. Some types of funds are already subject to leverage limitations. It is the case for UCITS funds, for French FIVG funds ("fonds à vocation générale", a subset of AIFs) and other identified categories of funds where leverage is limited. There is no need to have these types of funds in the perimeter. The scope should thus encompass funds that may make an excessive use of leverage compared to the asset class they invest in.

To be meaningful and effective, leverage methodologies cannot be disconnected from the notion of risk. Indeed, leverage is an issue linked to the amplification of market risk. We thus totally agree with FSB's statement that leverage measures should take due consideration of netting and hedging assumptions and be complemented by risk-based measures. AFG members are at the FSB's and IOSCO's disposal to detail the European's successful experience with the leverage calculations. We believe that the simple measure that FSB's mentions definitely corresponds to a Commitment calculation and the risk based one to a Value at Risk calculation. The interest of these calculations is triple: to be pertinent to funds' industry specificities; to permit to adapt to the type of investment portfolio; to allow setting a limit.

Our members are of the opinion that further assessment of the reality of risks on the issue of transferring mandates or client accounts should be undertaken before producing a recommendation in this field. An important feature to recall is that the security law that prevails in continental Europe is highly protective for the investor and could diminish the level of operational risk on such a transfer.

Q3. In your view, are there any practical difficulties or unintended consequences that may be associated with implementing the proposed policy recommendations, either within a jurisdiction or across jurisdictions? If there are any, please identify the recommendation(s) and explain the challenges as well as potential ways to address the challenges and promote implementation within a jurisdiction or across jurisdictions.

Our members see positive effects in terms of level playing field (avoidance of regulatory arbitrage) and of global firm scale economy of targeting a more harmonised regulation. In the same time, such a target should not be a blank cheque to overwrite or double existing effective regulation for the sake of harmonisation, especially when the market structures are not similar (degree of use of efficient portfolio techniques for instance). In addition, in some fields (like liquidity management or stress tests), being too prescriptive in terms of methodology may create systemic risk. Indeed, standardised parameters may induce mimetic behaviours in the market with all managers herding to buy or to sell in the same time. Last, but not least, asset management, at least in Europe, is highly and repeatedly regulated and risk taking is overly limited. The cost of new regulation/reporting implementation is ultimately borne by the man in the street. In the field of investment, this means less monies assigned to financing the global economy or to the welfare benefit of individual persons.

Reporting issues are a very important topic to our members.

[3] IOSCO's final report on "Liquidity Management Tools in Collective Investment Schemes: Results from an IOSCO Committee 5 survey to members" - https://www.iosco.org/library/pubdocs/pdf/IOSCOPD517.pdf

Rationalisation in this field is key. Our members strive to have a simplified and unique reporting to the authorities. An assessment of the real usefulness of information is also important. Over the last years, asset managers have been suffering a heavy burden of reporting: each new regulation incorporated its own reporting requirement and they proved difficult to implement. For liquidity matters, European asset managers already report with an AIFMD Format which was heavy to implement. We strongly urge FSB to build on the existing AIFMD reporting.

Reporting to public is not serving the same purpose as reporting to authorities and can prove easily to be confusing. Our members strongly advocate that fund liquidity schedules or stress tests results should not be made available to the public. Data difficult to grasp and/or subject to time and model instability may easily be misinterpreted and create unnecessary stress that would act as a catalyst for systemic risk.

Our members strongly support IOSCO's suggestion in the statement of its board regarding data gaps in the AM industry (June 2016) to use internationally agreed standards such as LEI or UTI (and UPI) and to foster the development of centralized data hubs.

Our members see challenges related primarily with the following recommendations:

Recommendation 6: *Authorities should require and/or provide guidance on stress testing at the level of individual open-ended funds to support liquidity risk management to mitigate financial stability risk. The requirements and/or guidance should address the need for stress testing and how it could be done. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.*

Our members are convinced that FSB and IOSCO should avoid being too prescriptive. Also, stress-testing should not replace a market-wide approach, which should take into account the type of trading whatever the profile of the market participant is.

Recommendation 9: *Where relevant, authorities should give consideration to system-wide stress testing that could potentially capture effects of collective selling by funds and other institutional investors on the resilience of financial markets and the financial system more generally.*

It is very important that FSB and IOSCO do not over-prescribe stress tests. In addition, stress-testing should not replace a market-wide approach, which should take into account the type of trading whatever the profile of the market participant is.

Recommendation 10*: IOSCO should develop simple and consistent measure(s) of leverage in funds with due consideration of appropriate netting and hedging assumptions. This would enhance authorities' understanding of risks that leverage in funds may create, facilitate more meaningful monitoring of leverage, and help enable direct comparisons across funds and at a global level. IOSCO should also consider developing more risk-based measure(s) to complement the initial measure(s) and enhance the monitoring of leverage across funds at a global level.*

We agree with the Recommendation 10. Our members insist on the plurality of approches and believe the text of the 10^{th} recommendation should unambigously refer to several measures: "consistent measure**s** of leverage in funds". As a reminder, a dual system with the commitment approach and the VaR approach should be preserved, as they have been tested successfully in Europe for long.

Recommendation 13: *Authorities should have requirements or guidance for asset managers that are large, complex, and/or provide critical services to have comprehensive and robust risk management frameworks and* *practices, especially with regards to business continuity plans and transition plans, to enable orderly transfer of their clients' accounts and investment mandates in stressed conditions.*

Our members do not see much risk for financial stability resulting from operational difficulties for an investor to change asset manager in the case of a fund or a mandate. In general, for matters related to operational risk, proportionality should in particular take into account the type of asset or strategy.

Q4. In your view, is the scope of the proposed recommendations on open-ended fund liquidity mismatch appropriate? Should any additional types of funds be covered? Should the proposed recommendations be tailored in any way for ETFs?

In general, our members believe the scope of open-ended funds is appropriate and that ETFs should be part of the scope.

We would like to recall that liquidity management is part of the portfolio management. AFG has already issued several documents of guidance on liquidity management and tools:

- AFG's Code of Practice on liquidity risk management in Collective Investment Schemes (CIS) - January 2016[4]
- AFG's Code of conduct on the use of stress tests[5]
- AFG's Code of conduct on Swing Pricing and variable ADLs[6].

AFG welcomes the FSB's positive mentioning of liquidity tools that attenuate the liquidity mismatch risk.

AFG would like to remind that CNAVs, which are a particular type of vehicle, work very different from the classical funds. Risks related to this structure have been identified by the systemic instances and are to be dealt by a new set of regulations. First, we would like to stress that the CNAV exception should not be considered as representative for the asset management's classical fund structures. And second, we would like to express hope that regulatory responses in the field of CNAVs do really tackle the systemic issues that originated the need for such a regulatory move.

Regarding the Recommendation 6 on stress testing, our members strongly advocate that the FSB and IOSCO should avoid being too prescriptive on how funds should design stress tests for their funds. If stress tests were the same across the world without taking into account the diversity of funds and underlying end-investors, such tests could provide highly misleading results and potentially become paradoxically a new, additional cause of systemic risk. Banking stress testing approach is in no case applicable to funds; they do not share the same objective.

The governance process around using liquidity risk management tools in Recommendation 7 is indeed important and is already robustly regulated in AIFMD and UCITS in Europe.

[4] http://www.afg.asso.fr/index.php/fr/textes/doc_download/5038-afg-code-of-practice-on-liquidity-risk-management-in-collective-investment-schemes-cis
[5] http://www.afg.asso.fr/index.php/fr/textes/doc_download/4936-code-of-conduct-on-the-use-of-stress-tests-april-2015
[6] http://www.afg.asso.fr/index.php/fr/textes/doc_download/4921-code-of-conduct-for-asset-managers-using-swing-pricing-and-variable-anti-dilution-levies-adl-2014-modified-january-2016

We are not convinced of the reasoning behind system-wide stress tests (in Recommendation 6), unless index funds (including ETFs) are becoming preponderant. Actively managed funds permit the divergence of positions and favour an active market with a healthy price formation. In theory, an actively managed and diverse environment favours market stability. AFG sees some "regulatory risk" in this space as some regulatory stances encourage beta investing over active management as well they encourage too much of a standardisation in the field of asset management. A too high relative importance of mimetic behaviours is pro-cyclical and creates bubbles.

AFG would like to recall that asset management is a matter of investment. Fiduciary duty goes with the unique interest of investors. It is not a good idea to suggest that the market liquidity for corporate bonds could rely on funds and fund managers. This is not our calling.

Our members suggest that FSB have in mind the "big picture" which stretches out also to structurally less-liquid asset classes like infrastructures, long term loans, real estate, unlisted securities… that are not subject to temporary liquidity mismatches but to structural illiquidity. Those assets are more rarely offered through open ended funds, but should be considered separately when they are.

Regarding the extreme case of absence of liquidity for ETFs due to a withdrawal of market makers that stop trading because of market instability, we think operationally the ETF will then start to work like a classic fund. FSB's attention should here be drawn on the fact that within the EU, ESMA issued guidelines applicable to UCITS ETFs, which notably deal with market disruption situations. Pursuant to these guidelines, in the absence of liquidity on the secondary market, or any significantly disrupted situation, the manager of the ETF would be compelled to accept redemption orders directly from shareholders at a price which should not be excessive. A specific wording describing this mechanism has been inserted in the ETFs' documentation by their managers. In this context, and from an EU ETFs' perspective, we see no need for further/different regulatory developments.

Q5. What liquidity risk management tools should be made available to funds? What tools most effectively promote consistency between investors' redemption behaviours and the liquidity profiles of funds? For example, could redemption fees be used for this purpose separate and apart from any impact they may have on first-mover advantage?

Our members strongly believe that competent authorities should allow as many tools as possible for fund managers, both in particular and exceptional circumstances. These tools are protective. As the understanding of the positive impact may not be of immediate reach, it is necessary to educate the public as to the reasons of these tools and their effect.

Redemption fees are the most meaningful when they take the form of an anti-dilution levy. Indeed, the key principle is the fairness to investors and as such a redeeming investor should bear the price of liquidity he generated. Redemption fees on a prescribed time schedule may also be meaningful in some cases linked to a less liquid global portfolio or some time depending activist strategies. It would harm the strategy and the remaining investors to redeem too early.

Q6. What characteristics or metrics are most appropriate to determine if an asset is illiquid and should be subject to guidance related to open-ended funds' investment in illiquid assets? Please also explain the rationales.

Liquidity is not a stable metric. Measures of liquidity can only be interesting on relative and indicative terms, as declaring a security is liquid or not once for all is nonsense. We urge FSB and IOSCO to avoid trying to define what is liquid or not. We do not believe that setting a ratio for illiquid securities is a good idea. Regulation is not done for one month; it should permit to perform the act of investing in different market situations.

Setting high level principles under the supervision of market regulators remains the best way to proceed, permitting asset managers, who best know their portfolio specificities, to supervise and regularly review their limits in terms of liquidity.

AFG is opposed to setting a regulatory minimum immediate liquidity cushion. If managers need this cushion in their management, they will implement it (with the right timing and calibration). There is no need to take the manager's hand in this field. It will prove to be inefficient for each portfolio individually and at macro scale. To take an example, we have eagerly accepted in the past the principle of such a regulatory buffer for MMFs because our managers were using it in their day to day liquidity management. It was good practice as immediate liquidity cushions are totally adapted to the style of management of a MMF, as the promise of liquidity to investors in such a fund has a high importance. However, the implementation of the buffer in the proposal for a European MMF Regulation failed to take stock sufficiently of the VNAV specificities to make liquidity on the market, the available very short term liquidity instruments. It is very difficult for us today to convince that the proposed calibrations are wrong. So, we recommend careful thinking before imposing regulatory ratios, because regulatory standardised ratios are unfortunately not having the same efficiency as a fine tuned asset manager's internal practice (adapted to the strategy and type of client).

Regarding liquidity information to the public, only a narrative and qualitative approach (like the one currently proposed by PRIIPS[7]) can be appropriate.

Q7. Should all open-ended funds be expected to adhere to the recommendations and employ the same liquidity risk management tools, or should funds be allowed some discretion as to which ones they use? Please specify which measures and tools should be mandatory and which should be discretionary. Please explain the rationales.

AFG members stress the importance of discretion and flexibility in the use of risk management tools. They think that each tool should be used wisely and when appropriate. It depends on the portfolio, on the shareholders' structure, on the type of markets, etc. The manager should have at his disposal a maximum of tools so as to allow coping with different types of market situations. The definition of the rules of activation and a clear governance of the process should be set.

The ideal regulations would list all available tools in the legal framework so as to permit the use of the most appropriate (one tool or a mix of tools). The interest of such a regulation would be to ensure there is no incentive, from a competition standpoint, to ban some tools from the fund prospectus and thus give investors the false impression that this fund in particular is liquid on this asset class at all times and/or that redeeming investors would receive their cash in all situations. Unless there is a formal third party guarantee from a prudentially regulated institution (which was granted by regulation the right to give enforceable guarantees), it is the investors who bear the investment risk and they should benefit from

[7] PRIIPS designates the Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs). Those producing or selling packaged retail investment and insurance-based investment products (PRIIPs) will have to provide key information documents (KIDs) from the end of 2016.

equal/fair treatment. This is already the case of the suspension in European law. We believe this could also be the case of gates. In any case, when new tools meant to protect investors are available, it is considered counterproductive to give investors the choice to leave because a new tool is being added. Otherwise, these tools will not be implemented and ready for use in many funds and the next crisis will result in stressed liquidity conditions that funds will have the same old difficulties to manage.

AFG strongly disagrees with a standardised regulatory stress testing programme. Even if it is well intentioned, the result will necessarily be with little connexion to the real risk to be captured in a particular type of fund. Either the type of fund is not having sufficient risk factors and/or capacity of amplification of risks to justify being in the perimeter or the fund really needs such a scrutiny (and in the latter case, the stress test should be appropriately calibrated to be meaningful). In addition, it should be clearly mentioned that asset managers do not manage their funds by looking at the stress test results, which are extreme case simulations. Last but not least, asset managers are not banks and the banking stress testing approach cannot be transferred to funds. We do not clearly see the reasoning behind the recommendation n° 9 that confuses the role of NCA[8]s to aggregate risk measurements to gain a global view of potential risk and the stress testing exercise that is only meaningful at the level of the fund. We do not find evidence to support a "collective behaviour" risk in asset management. The best defence against such an unlikely risk is to ensure flexibility in the way management is performed.

Q8. Should authorities be able to direct the use of exceptional liquidity risk management tools in some circumstances? If so, please describe the types of circumstances when this would be appropriate and for which tools.

Competent authorities already possess the power to direct the use of exceptional tools. It is important that authorities act in cooperation with both affected funds and the industry as a whole when facing such situations. Equally, fund managers would obviously be expected to coordinate closely with their competent authorities before employing exceptional liquidity risk management tools. This is particularly the case for subscriptions/redemptions suspensions or gating.

It the meantime, it should be mentioned that we do not believe that tools should be actionable only on request or with the validation of the NCA. The governance body of the liquidity management risk process should be responsible for supervision and decision.

As mentioned at the previous question, we believe that the introduction of new tools (either by the asset manager of by way of regulation) should be made with immediate application and made known to the public by any means. This is the only way to favour tool implementation and get ready in case of serious stress or crisis.

Q9. In developing leverage measures (Recommendation 10), are the principles listed above for IOSCO's reference appropriate? Are there additional principles that should be considered?

There is no unique measure of leverage that can adequately grasp the capacity of amplification (the gearing) of underlying risks in all types of funds.

In Europe, after years of hard work regulators created a set of leverage measures. We tested them for a number of years and we believe we can conclude that a multiple measure of leverage continues to be the

[8] NCA designs in the European jargon a National Competent Authority (for instance AMF for French funds)

best solution. Investment funds, whether open-ended or closed-ended, represent a very wide diversity of investors and employ a wide diversity of investment strategies. Different measurements of leverage are appropriate to be more meaningful depending on the type of fund.

To be meaningful and effective, leverage methodologies cannot be disconnected from the notion of risk. Indeed, leverage is an issue linked to the amplification of market risk (gearing). We thus totally agree with FSB's statement (in Recommendation 10) that leverage measures should take due consideration of netting and hedging assumptions and be complemented by risk-based measures. AFG members are at the FSB's and IOSCO's disposal to detail the European's successful experience with the leverage calculations. We believe that the simple measure that FSB's mentions definitely corresponds to a Commitment calculation and the risk based one to a Value at Risk calculation (UCITS rules permit the use of either absolute VaR or relative VaR[9] indicators). The interest of these types of measures is triple: to be pertinent to funds' industry specificities; to permit to adapt to the type of investment portfolio; to allow setting a limit (where needed).

Although interesting, gross figures are less meaningful in terms of real capacity of amplification on a given risk and they incorporate also other type of indications, such as on counterparty risk.

We are convinced that a new measure from scratch will do no better than currently existing regulatory set in Europe, which has been positively tested for many years. We thus don't think that the objective should be the harmonisation at all costs, especially when there are other types of implications such as leverage limitations (UCITS funds and UCITS like funds for instance) or client reporting. Too simple an approach may eventually not permit efficient portfolio management, which adds value for investors.

Measurement is a way to put a warning and draw attention of the supervisor. In order to avoid false signals, it is important to properly calibrate the measure and to choose the relevant methodologies and scope.

Q10. Should simple and consistent measure(s) of leverage in funds be developed before consideration of more risk-based measures, or would it be more appropriate to proceed in a different manner, e.g. should both types of measure be developed simultaneously?

AFG strongly believes that the European example is a good one. Some funds' risk may not adequately be captured by the commitment method. This is why the VaR method is used as an alternative. We cannot see the rationale to develop the framework only partly.

Q11. Are there any particular simple and consistent measures of leverage or risk-based measures that IOSCO should consider?

Yes, we would like to give the UCITS example of a set of two principal alternative methodologies: a commitment method (a more simple method) and a Value at Risk (absolute and relative). A complementary method permits to apply the commitment method to some particular types of structured funds.

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[9] The Relative VaR is defined (by the CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS - https://www.esma.europa.eu/sites/default/files/library/2015/11/10_108.pdf) as the VaR of the fund divided by the VaR of a benchmark or a reference portfolio (i.e. a similar portfolio with no derivatives). UCITS portfolios (as well as French AIFs that are UCITS like) use this alternative measure of gearing to comply with the global exposure limit (200%). Indeed, the VaR on the UCITS portfolio should not exceed twice the VaR on the reference portfolio.

In Europe, two principal alternative methods permit to adapt to the particular type of strategies operated within a fund (one adapted for more simple and straightforward strategies – the "commitment method" - and another one for more complicated strategies or instruments used and particularly where the commitment method would not help to apprehend correctly the underlying risk – the "Value at Risk method").

- Regarding the "commitment method" (which constitutes a linear approximation), detailed provisions of netting, duration-netting, hedging (with the market value of security positions that can be used to offset gross commitment) and cash netting (when cash + derivative is equivalent to holding a cash position in the given financial asset) permit to adjust the method to give a more precise view of the real capacity of amplification of risks present in the fund.

- Regarding the "Value at Risk method", provisions of stress testing and back testing complement the use of the method. The use of the VaR method allows for integrating all types of instruments in the calculation and thus permits financial innovation. The VaR method allows for balancing different types of instruments' risks (which is not the case for exposure-based methods, such as the commitment method). Indeed, the commitment method simply adds up equity risk and fixed income risk. Leverage calculations should properly reflect the market risks. Developments implemented by the European Securities Markets Authority (ESMA) regarding possible netting among financial instruments based on their sensitivity to different market variables under the commitment method definitely remain a huge accomplishment. Nevertheless, the commitment method remains "empirical" in the sense it cannot be exhaustive and favours certain strategies over others. Even if correlations are time-varying, global exposure calculated through methods that take into account risks that effectively compensate, like VaR, are more precise provided that the models used are properly calibrated through an extensive back testing.

Q12. What are the benefits and challenges associated with methodologies for measuring leverage that are currently in place in one or more jurisdictions?

The Commitment and VaR methodologies we have mentioned before have been successfully tested in Europe at least since 2006.

The EU regulation and more precisely the two directives, UCITS and AIFM address in depth the question of leverage in a fund. Our members insist on the fact that Europe has developed a strong regulatory framework that limits leverage of funds. This goes back to many years for UCITS and is more recent for AIFs. The EU has already identified leverage as a risk in the asset management industry and addressed it with a set of two principal measures (The Commitment measure and the VaR measure). Gross measures are also part of the package in the AIFM framework, but they are less meaningful in terms of real capacity of amplification on a given risk and they incorporate also other type of indications, such as on counterparty risk. The Commitment method is also adapted to a scenario based commitment method for the particular case of certain types of structured funds.

The leverage measures mentioned are focusing on the leverage stemming from the use of derivatives. Balance sheet borrowing is the exception and is not allowed for funds offered to the public; UCITS for example can borrow up to 10% of their NAV and this facility is generally provided for by the depositary with a view to heal a breach in the settlement process of a transaction; the same applies for UCITS like AIFs offered to the public. Also, UCITS and UCITS like AIFs offered to the public cannot build leverage through repos or securities lending since European regulation prevents from using cash collateral for investment purposes.

We believe that European regulators are right to have set leverage measures that relate to risk, not to a simple sum of notionals, as the objective is to minimise the risks to investors and the system. The European method accounts for the netting and hedging of value of derivatives used that truly act as hedges, i.e. actually act to reduce the risks (it should be mentioned also that the netting and hedging arrangements involve also security positions, ie the market value of security positions can be used to offset gross commitment). For instance, the use of currency derivatives are most of the time meant to be hedges so as to effectively temper the effects of currency fluctuation on the fund's returns. A too simple method may give as risky a strategy using heavily currency hedging, while the actual result is a fund that reduces currency and volatility risks. And in conjunction with rules regulating the counterparty risk (such as collateral measures and/or central compensation as well as counterparty risk limits[10]), there is no additional risk brought to the fund.

It is also important to note that the use of derivatives may also be a less costly and more liquid means of obtaining an exposure to a financial asset without changing the risk profile of the fund. This is why there are in the case of commitment calculation some compensation rules between the derivative and the amount of cash held in portfolio (this is equivalent to holding a cash position in the given financial asset).

We believe that FSB should mandate IOSCO to analyse existing regulations and measurements of leverage of funds in different jurisdictions and discuss with the local or regional authorities to gain a better flavour of possible outcomes. We strongly suggest capitalizing on the experience of UCITS and AIFMD in the EU.

Q13. Do you have any views on how IOSCO's collection of national/regional aggregated data on leverage across its member jurisdictions should be structured (e.g. scope, frequency)?

We believe that existing UCITS and AIFM reporting should be taken into account to allow for the aggregation of data at IOSCO level.

It would be unfair that those jurisdictions that are ahead in the field of reporting of leverage be penalized by the introduction of new requirements. A full assessment of the existing system and its efficiency is needed.

We believe that a semi-annual collection of data is far sufficient and that the scope should only include relevant funds (such as significant in size and leverage or combining high leverage and a good proportion of assets with a low liquidity, etc). Only some funds need to be spotted. The false good idea would be to have such a large scope that too many funds are captured inefficiently.

Q14. Do the proposed policy recommendations on liquidity and leverage adequately address any interactions between leverage and liquidity risk? Should the policy recommendations be modified in any way to address these interactions? If so, in what ways should they be modified and why?

[10] These rules are part of the European regulatory framework either through the EMIR Regulation or product regulation such as the UCITS Directive.

FSB rightly acknowledges the importance to spot funds that cumulate high leverage (more than 12 times for instance) with less liquid underlying assets. The importance of the net assets of the fund also adds to the criteria. These funds should be monitored more frequently. Availability of risk management expertise for the asset managers of these funds is also to be looked at.

European regulation and good practices already exist in this field.

Q15. The proposed recommendation to address the residual risks associated with operational risk and challenges in transferring investment mandates or client accounts would apply to asset managers that are large, complex, and/or provide critical services. Should the proposed recommendation apply more broadly (e.g. proportionally to all asset managers), or more narrowly as defined in Recommendation 13? If so, please explain the potential scope of application that you believe is appropriate and its rationales.

Our members do not see much risk for financial stability resulting from operational difficulties for an investor to change asset manager in the case of a fund or a mandate. In general, for matters related to operational risk, proportionality should in particular take into account the type of asset or strategy. Business continuity plans are important in this field. Asset segregation and correlative protections at depositary level are key.

Our members encourage FSB to go one step further following foot note 52 page 28. Data providers have an oligopolistic position, which could give rise to a systemic level of risk. There should be more attention and scrutiny paid to these activities/actors.

Q16. In your view, what are the relevant information/data items authorities should monitor for financial stability purposes in relation to indemnifications provided by agent lenders/asset managers to clients in relation to their securities lending activities?

AFG believes that some transparency should be given to the investor regarding this type of risk and that the asset manager be subject to the prudential rules adequate for this type of on balance sheet activity.

Q17. Should the proposed recommendation be modified in any way to address residual risks related to indemnifications? For example, should it be more specific with respect to actions to be taken by authorities (e.g. identifying specific means for covering potential credit losses) or more general (e.g. leaving to authorities to determine the nature of appropriate action rather than specifying coverage of potential credit losses)?

AFG believes that indemnifications in the context of securities lending activities should require that capital covers for the specific risk of this activity. This is a banking type of activity, as indemnifications mean in practice putting financial risks on the balance sheet of the relevant company. This is very different from the usual activities of asset management companies, which are only agents on behalf of their clients which take the financial risks.

If you need any further information, please don’t hesitate to contact our association at a.gurau.audibert@afg.asso.fr.

Sincerely Yours,

Adina Gurau Audibert