CD/SJ – 08.04.2014

AFG response to FSB-IOSCO consultative document on

assessment Methodologies for Identifying Non-Bank Non-Insurer

Global Systemically Important Financial Institutions

The Association Française de la Gestion financière (AFG)[1] is grateful for the opportunity to respond to FSB-IOSCO consultative document on assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions (SIFIs).

We understand that FSB-IOSCO should wish to complete the framework for Global Systemically Important Financial Institutions and to establish methodologies consistent with those applying to banks and insurer Global Systemically Important Financial Institutions. However, we would like to stress the specificities of asset management - **asset managers manage assets on behalf of their clients** and have a fiduciary duty toward them. In other words, assets do not belong to asset managers, they remain the ownership of investors and are

[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).

kept and overseen by a depositary, which is not the case in other parts of the world. Asset managers do not perform proprietary trading activities.

This is for instance reflected on page 29 of the consultation paper: “funds contain a specific “shock absorber feature that differentiates them from banks. In particular, fund investors absorb the negative effects that might be caused by the distress or even the default of a fund, thereby mitigating the eventual contagion effects in the boarder financial system”.

We generally support the approach proposed by FSB-IOSCO regarding asset management:

- We agree that, in the sector of asset management, the definition of Non-Bank Non-Insurer Global Systemically Important Financial Institutions should focus on investment funds, for the following main reasons:

    - We agree that the definition should focus on funds rather than on asset management companies. Indeed, asset management companies as such do not generate systemic risk: in case they default, the assets they manage on behalf of their clients (which are not in their balance sheet but safekept by a depositary) can easily be transferred to another asset management company. Moreover, the financial health of asset management companies is closely monitored by their regulator which can if required make sure this transfer is completed in a timely fashion. In this context of financial health, it seems consistent that prudential rules, a certain level of supervision and adequate reporting be required for the relevant asset management companies.

    - We believe that families of funds would be too difficult to define as such.

    - In our opinion, separately managed accounts are not systemically relevant. Indeed, such accounts are by definition separate; they do not bear any risk of default or any risk of run.

- We believe that the proposed thresholds applying to investment funds in terms of AUM and GNE are reasonable. In the specific case of funds with compartments, we would like to clarify that, if relevant, these thresholds should be applied at the level of each compartment.

- We would like to clarify that size criteria (AUM and GNE) should be used as a first filter to determine the investment funds that should be further assessed. In other words, the other proposed criteria should only apply to funds that are above the size thresholds, in order to decide whether they actually are systemically important. Indeed, these other proposed criteria would be too burdensome to calculate for all investment funds.

Very importantly, as a general comment on this consultation, in terms of method, we would like to stress that it is very difficult for us to assess the proposed methodology in an appropriate manner, as we do not know what measures will be considered and eventually applied to the investment funds if identified as systemically important.

*

**

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?

We agree with the transmission channels identified by FSB – IOSCO. In our opinion, the three channels described in the consultation paper (i.e. exposures, asset liquidation, substitutability) make sense.

We would like to note here that investment funds are substitutable and that as a consequence financial distress will not be transmitted through the substitutability channel as far as funds are concerned. Indeed, the functions and services performed by investment funds can be performed by other funds: in other words, investors have alternative options for making their investments. As described on page 32 of the consultation, "most investment funds are generally substitutable". Moreover, investors have alternative options for investing in different funds, as the offer of funds on the market is wide. As described on page 30, "the investment fund industry is highly competitive with numerous substitutes".

We do not think that there are additional channels that need to be considered.

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?

Yes, we believe that the high-level framework for identifying NBNI G-SIFIs (including the five basic impact factors i.e. size, interconnectedness, substitutability, complexity and global activities) adequately captures how failure of NBNI financial entities could cause significant disruption to the wider financial system and economic activity.

In our opinion, the five impact factors might not have the same weight in different situations. They should not be considered in isolation from each other, rather, they should be combined and considered together.

We would like to clarify that the size impact factor should be used as a first filter to determine investment funds that should be further examined. In other words, the four other impact factors should only be considered for funds that are above the size thresholds, in order to decide whether they actually are systemically important.

We do not think that there are other impact factors that should be considered in addition to those currently proposed in the consultation paper.

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?

We support the approach proposed by FSB-IOSCO to develop sector specific methodologies and agree that both open-ended and closed-ended funds, regardless of whether their units are traded on regulated or organised markets, should be covered by the methodology.

As far as separately managed accounts are concerned, we believe that they are not systemically relevant. Indeed, such accounts are by definition separate; they do not bear any risk of default or run.

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?

We agree with the proposed scope of assessment.

We support the approach proposed by FSB-IOSCO to develop sector specific methodologies and agree that investment funds should be covered by the methodology. The focus should be first on funds rather than on asset managers: it is more legitimate from an investor perspective in terms of contamination

In this context, we would like to clarify that there are different types of investment funds. More precisely, funds might present a different level of systemic risk depending on their specific nature. For example, equity funds or moderately leveraged funds as well as Variable NAV money market funds do not cause any systemic risk.

We believe that the definition of systemically important financial institutions in the sector of asset management should focus on funds. Indeed, as explained previously, asset management companies do not generate systemic risk as in case they default the assets they manage on behalf of their clients can easily, as they are not in their balance sheet but safekept by a depositary, be transferred to another asset management company. Moreover, their financial health is closely monitored by their regulator which can if required make sure this is completed in a timely fashion. In this context, it seems consistent that prudential rules, a certain level of supervision and adequate reporting be required for the relevant asset management companies.In any case, in the European Union, there already are methodologies which apply to UCITS, AIFs and MMFs. Regarding investment funds, the EU has already set its focus on hedge funds (and more widely AIFs) as well as MMFs. Regarding MMFs, the EU

(ESRB) has clearly stated that CNAV MMFs generate a specific systemic risk. At FSB level, equity funds were not considered as a source of systemic risk. And funds with a limited leverage should not be considered as a source of systemic risk.

Furthermore, we think that families of funds would be too difficult to define beyond mere clones.

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).

We believe that the proposed size thresholds in terms of AUM and GNE are reasonable. More precisely, we would like to clarify that, if relevant, these thresholds should be applied at the level of each compartment of a fund, as each fund compartment is completely independent from the fund as a whole.

In this context, we would like to highlight that materiality thresholds defined at a global level should be implemented in the same way in all national jurisdictions. We believe that there should not be any possibility for gold (or “tin”) plating as this would create regulatory arbitrage and an unlevel playing field.

Furthermore, we would like to clarify that the size thresholds should be used as a first filter to determine investment funds that should be further examined. In other words, the four other impact factors should only be considered for funds that are above the thresholds, in order to decide whether they actually are systemically important.

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

There might be some practical difficulties in applying the materiality thresholds when a fund has a size which is close to them. Clarification would be required to deal with such situations: for instance, it would be useful to specify the frequency of the monitoring of the AUM or GNE.

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.

We believe that the proposed threshold level is appropriate.

It would however be relevant to clarify at global level which investment funds should be considered as hedge funds. In our opinion, **UCITS, and AIFs that do not use a significant level of leverage** (i.e. AIFs that use a level of leverage under 3 as per the AIFMD) **should not be considered as hedge funds.**

The principles/guidelines already developed by IOSCO could be applied to funds other than UCITS and AIFs which do not use a significant level of leverage in order to identify hedge funds - i.e. hedge funds are those declaring themselves as a “hedge fund” or presenting a combination of specific characteristics in particular (a) use of leverage, (b), performance fees based on unrealized gains, (c) complex strategies, (d) tendency to invest in financial rather than physical assets.

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).

No, we do not think that it would be beneficial to set additional materiality thresholds based on “global activity” for investment funds. In our opinion, only thresholds based on size (AUM or GNE) are relevant.

Q4-1. In your view, does the proposed definition of finance companies 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?

Q4-2. Do you think that the above description of systemic importance of finance companies adequately captures potential systemic risks associated with their financial distress or disorderly failure at the global level?

Q4-3. Are the proposed indicators appropriate for assessing the relevant impact factors? For example, for consistency purposes the methodology uses “intra-financial system assets” and “intra-financial system liabilities” as defined in the G-SIB framework, but should it consider other indicators that are more tailored to a finance company’s business model and risk profile? Also, should the methodology focus not only on OTC derivative exposures but also centrally-cleared derivatives in assessing “interconnectedness” and “complexity”?

Q4-4. Are there additional indicators that should be considered for assessing the relevant impact factors? If so, please also explain the possible indicators and the reasons why they should be considered.

Q4-5. 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 solutions including possible proxies that could be collected or provided instead.

Q4-6. Should certain indicators (or impact factors) be prioritised in assessing the systemic importance of finance companies? If so, please explain which indicator(s) and the reasons for prioritisation.

Q5-1. In your view, does the proposed definition of market intermediaries 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?

We would like to highlight here that the activities of reception and transmission of orders and providing advice do not in our opinion generate systemic risk.

Besides, we believe that the definition of market intermediaries should be implemented in the same way in all national jurisdictions. We believe that there should not be any possibility for gold plating as this would create regulatory arbitrage and an unlevel playing field.

Q5-2. How should the sector-specific methodology account for firms that perform intermediary functions through registered broker-dealers or securities firms in some jurisdictions but through dually-licensed banking entities in other jurisdictions?

Q5-3. Do you think that the above description of systemic importance of market intermediaries adequately captures potential systemic risks associated with their financial distress or disorderly failures at the global level?

Q5-4. Are the proposed indicators appropriate for assessing the relevant impact factors? In particular, are there more appropriate indicators for "substitutability" and "complexity" that should be considered? If so, please explain the indicator and the reasons why such measures are more appropriate.

Q5-5. 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 solutions including possible proxies that could be collected or provided instead.

Q5-6. Are there additional indicators that should be considered for assessing the relevant impact factors (For example, should "number of clients" or "number of types of clients" also be considered for "size")? If so, please also explain the possible indicators and the reasons why they should be considered.

Q5-7. Should certain indicators (or impact factors) be prioritised in assessing the systemic importance of market intermediaries? If so, please explain which indicator(s) and the reasons for prioritisation.

Q5-8. In your view, is there a need for more specific quantitative guidelines for any indicators that should be proposed? If so, please explain which indicator(s) and the possible appropriate quantitative guidelines.

Q5-9. In light of the G20 commitment to require all standardised OTC derivatives to be centrally-cleared, should the methodology include "amount of margin required at clearing houses or CCP" as an indicator for assessing "interconnectedness"? If not, please explain why.

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?

We agree that 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.

As explained previously, we believe that, in Europe, **UCITS, and AIFs that do not use a significant level of leverage** (i.e. AIFs that use a level of leverage under 3 as per the AIFMD) **should not be considered as hedge funds.**

The principles/guidelines already developed by IOSCO could be applied to funds other than UCITS, and AIFs which do not use a significant level of leverage, in order to identify hedge funds - i.e. hedge funds are those declaring themselves as a "hedge fund" or presenting a combination of specific characteristics in particular (a) use of leverage, (b), performance fees based on unrealized gains, (c) complex strategies, (d) tendency to invest in financial rather than physical assets.

Again, we would like to clarify that the size thresholds should be used as a first filter to determine investment funds that should be further assessed. In other words, the other criteria should only be considered for funds that are above the thresholds, in order to decide whether they actually are systemically important.

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?

Yes, we believe that the description of systemic importance of asset management entities adequately captures potential systemic risks associated with their financial distress or disorderly failure at the global level.

We would like to take this opportunity to insist on the specificities of asset management. Asset managers manage assets on behalf of their clients and have a fiduciary duty toward them; assets do not belong to asset managers, they remain the ownership of investors and are kept by a depositary which also performs important overseeing tasks. Asset managers do not perform proprietary trading activities.

This is for instance reflected on page 29 of the consultation paper: "funds contain a specific "shock absorber feature that differentiates them from banks. In particular, fund investors absorb the negative effects that might be caused by the distress or even the default of a fund, thereby mitigating the eventual contagion effects in the boarder financial system".

Besides, we would like to highlight that the functions and services of investment funds could be performed by other funds: indeed, investors have alternative options for making their investment. As explained on page 32 of the consultation, "most investment funds are generally substitutable". Investors also have alternative options for investing in funds, as the offer of fund on the market is wide. As described on page 30, “the investment fund industry is highly competitive with numerous substitutes”.

In this context, it seems consistent that prudential rules, a certain level of supervision and adequate reporting be required for the relevant asset management companies.We would also like to highlight that European asset management companies are already regulated and comply with prudential measures. In particular, both the UCITS Directive and the AIFM Directive contain capital requirements and reporting obligations that provide regulators with a holistic view of the asset management company.

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.

We agree that the systemic importance of the asset management sector should be assessed at the level of investment funds.

Indeed, asset managers on a stand-alone entity basis are not systemically relevant. As explained previously, the main risk relating to an asset manager is that it might not be able to manage the assets of its clients any longer. In Europe, asset managers have to comply with own capital requirements and regulators have the tools required to monitor their level of own capital and are in a position to be warned of any potential failure by an asset manager. Would such a failure actually occur, assets (they are not in the asset manager’s balance sheet) would be transferred to another asset manager that would take over the management of the assets. Again, we understand that a problem arising at the level of one systemically important fund might indirectly impact the management company that manages it. Such a risk contagion from one systemically important fund to the management company may therefore justify putting in place prudential measures at the level of the management company such as additional capital requirements if the fund is considered as systemically important.

Moreover, we believe that families of funds would be too difficult to define beyond mere clones. Indeed, it would not make sense to consider altogether for example all equity funds or all fixed income funds.

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.

No, we do not think that the methodology should be designed to focus on whether particular activities or groups of activities pose systemic risks.

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.

Only size criteria can be easily comprehended as they are simple and objective criteria. As explained previously, we believe that they should be used as a first filter to determine investment funds that should be further examined. In other words, the other criteria should only be considered for funds that are above the size thresholds, in order to decide whether they actually are systemically important.

The number of proposed indicators is very high (16 indicators in total) and would be definitely too burdensome to apply to all investment funds. Besides, the calculation of most of them would be very complicated. Furthermore, it is not clear why these indicators have been chosen and how they should be appreciated (there are no materiality thresholds attached to these criteria).

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?

We believe that the criteria relating to cross jurisdictional activities do not make sense. Indeed, it could be argued that a large fund operating in different countries is less risky than a large fund operating in a single country, as geographical diversification could help to reduce the risk borne in each country.

We therefore do not believe that the fund's use of service providers in other jurisdictions should be used.

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

We think that AUM and GNE are appropriate for assessing the size of investment funds.

We would like to note here that EU investment funds already comply with detailed reporting requirements. It would therefore be helpful if the methodologies developed by the FSB-IOSCO were consistent with those used to fulfill the obligations of the AIMFD and use the same calculation methodologies.

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

We would like to stress that investment funds are substitutable and that as a consequence financial distress will not be transmitted through the substitutability channel as far as funds are concerned. Indeed, the functions and services performed by investment funds can be performed by other funds: in other words, investors have alternative options for making their investment. As described on page 32 of the consultation, “most investment funds are generally substitutable”. Moreover, investors have alternative options for investing in different funds, as the offer of funds on the market is wide. As described on page 30, “the investment fund industry is highly competitive with numerous substitutes”.

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.

We do not understand why indicator 3-3 relating to investment strategies or asset classes with less than 10 market players globally should be relevant. No justification is provided.

Indicator 4-1 relating to OTC derivatives trade volumes at the fund / total trade volumes at the fund should only relate to non-cleared OTC derivatives, as cleared derivatives do not generate systemic risk.

Indicator 4-3 relating to the ratio of NAV managed using HFT strategies is not relevant for investment funds, as asset managers are not the main players regarding HFT activities. We do not understand why this indicator should be used in the sector of asset management.

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.

No, we do not believe that there are additional indicators that should be considered for assessing the relevant impact factors.

As explained previously, the number of proposed indicators is indeed very high (16 indicators in total) and would be definitely too burdensome to apply to all investment funds. Besides, the calculation of most of them would be very complicated. Furthermore, it is not clear why these indicators have been chosen and how they should be appreciated (there are no materiality thresholds attached to these criteria).

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.

We believe that only size criteria can be easily comprehended as they are simple and objective criteria. As explained previously, we believe that they should be used as a first filter to determine investment funds that should be further examined. In other words, the other criteria should only be considered for funds that are above the thresholds, in order to decide whether they actually are systemically important.

Q7-1. In your view, does the approach set out in this section adequately identify as a "backstop" any potential G-SIFIs not captured by the sector-specific methodologies?

*

**

Would you need any further information, please feel free to contact our Head of International Affairs Division, Stéphane Janin, at +33 1 44 94 94 04 (s.janin@afg.asso.fr), our Deputy Head of International Affairs Division, Carine Delfrayssi, at + 33 1 44 94 96 58 (c.delfrayssi@afg.asso.fr) or myself at +33 1 44 94 94 29 (p.bollon@afg.asso.fr).

Sincerely yours,

(Signed)

Pierre Bollon

*

**