Questionnaire for Regulatory Capital Review

RESPONSE OF EUROPEAN ASSET MANAGEMENT ASSOCIATION TO QUESTIONS CONCERNING EUROPEAN ASSET MANAGEMENT INDUSTRY

Do you support the intention of making the standardised approach for operational risk accessible to a wider range of institutions on the basis of reasonable risk management standards? Specific suggestions - drawing from the industry's best practice of risk management standards - are welcome:

EAMA believes that there is no justification for a capital requirement for asset management companies in respect of operational risk as asset management companies do not pose any significant systemic risk and there are better regulatory approaches to investor protection which would cause little or no damage to the asset management industry.

If making the standardised approach accessible to a wider range of institutions, however, means giving asset management companies the option of using it or not, as opposed to obliging them to use it, this would be preferable to denying them that option and obliging them to use some other approach.

Do you find the provisional calibration of the standardised approach as presented in the Basel Supporting document on operational risk relevant in the EU context? Input from federations of small and/or specialised institutions is specifically sought. Comments on the relative weightings of business lines (see table 1 of annex 3 of the Basel Supporting document) and the preliminary betas (see annex 3 of the Basel Supporting document) are specifically invited. Numerical evidence of the impact on specific industries will be most welcome:

The standardised approach is based on five dubious assumptions:

1 The total MRC for banks is appropriate.

2 Banks allocate an appropriate proportion of MRC to operational risk.

3 The amount of capital to cover operational risk should be allocated to business lines in proportion to the size of those business lines.

4 The proportion thus allocated to the asset management business should be used to determine the appropriate level of capital in the European asset management industry, including the substantial part not owned by banks.

5 The operational risk inherent in the asset management business is correlated approximately with funds under management.

The recent report on "Risks and Regulation in European Asset Management: Is there a Role for Capital Requirements?" by Professor Julian Franks of the London Business School, Professor Colin Mayer of the Saïd Business School and Oxford Economic Research Associates Ltd. found that the maximum operational loss for the sample examined as a proportion of total assets under management is 0.0094%. The report suggests that even under very pessimistic assumptions the financial impact of the potential largest loss for large asset management companies would be less than 0.06% of assets under management. This data suggests that a beta of tenths of a percent would be excessive and that a beta of between 1 and 5 basis points would be more appropriate.

Do you support the intention of developing a spectrum of internal-based methodologies for operational risk in the future, to facilitate the transition from the standardised approach to more sophisticated methodologies?:

Yes but the approaches included in the spectrum should not be so complex that it is more difficult to assess a capital requirement using them than using more sophisticated methodologies.

What risk mitigation techniques (other than mandatory professional liability insurance) do you think deserve recognition under the standardised approach for operational risk? Please specify what qualifying criteria such techniques should meet (legal robustness, timeliness of payments…) and how the risk mitigating effect could be factored in the standardised approach:

Voluntary professional liability insurance that satisfy regulatory criteria in respect of solvency of the insurer and legal enforceability.

Custody of assets under management by external or non group professional custodians.

Monitoring or approval of transactions by independent trustees.

Legally binding guarantees of liabilities provided by a parent or related group company which satisfies specified solvency criteria.

We are opposed to the use of funds under management as an indicator of operational risk but, if funds under management are used as an indicator of operational risk, the funds which are protected by any of the above should be deducted from funds under management in calculating the capital requirement.