Amundi
ASSET MANAGEMENT

AMUNDI'S answer to the Consultative Document issued by Basel Committee on Banking Supervision on

IDENTIFICATION AND MEASUREMENT OF STEP-IN RISK

(March 17, 2016)

Amundi is the leading asset manager in Europe and ranks in the top 10 of the industry worldwide, with assets under management above € 985 billion at the end of 2015. Located at the heart of the main investment regions in more than 30 countries, Amundi offers a comprehensive range of products covering all asset classes and major currencies. Amundi has developed savings solutions to meet the needs of more than 100 million retail clients worldwide and designs innovative, high-performing products which are tailored specifically to the requirements and risk profile of institutional and corporate clients. Amundi is a listed company with Credit Agricole Group as its majority shareholder. For prudential regulation purpose, Amundi is consolidated within Credit Agricole Group and subject to minimum capital requirements on the concerned activities.

Amundi is very much concerned with the discussion about market finance and all the fears that the expression "shadow banking" conveys, which are in our opinion largely unjustified as far as asset management is concerned. More specifically, when reading the consultation document on step-in risk issued by Basel Committee on Banking Supervision (BCBS), we realise how important it is for us to provide an in depth explanation of our business. We are thankful to the BCBS for the opportunity that it offers through the present consultation to bring elements that may help clarify where we feel the focus should be placed.

First, Amundi would like to remind BCBS of specificities that fundamentally oppose banking and Asset Management industries :

- Asset managers (AM) act as agents for clients that pay them to run their money according to the risk/return profile they agree upon; AM are highly conscious that they have a fiduciary duty towards their client investors; mandates or open funds, whatever the legal framework, there is no risk on the balance sheet of the AM.
- Asset management is very highly regulated at the level of the management company, of the fund, of specific activities and the distribution and client relationship; it is closely supervised as well by European and National Competent Authorities; in the European Union we can mention legislations specific to our industry like UCITS, AIFMD… or impacting our activities like MIFID/MIFIR, EMIR, SFTR… or impacting our clients and indirectly ourselves like CRD, CRR

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and Solvency 2 … Those regulations should be clearly and more specifically mentioned in the 1.2 Part (*"Subsequent accounting and other developments since the financial crisis"*).

- Like Amundi, some AM carry activities that require a banking license or belong to a banking group and are partly prudentially regulated; other asset management activities have been assimilated to market finance and shadow banking; the FSB clearly stated in July last year http://www.fsb.org/2015/07/next-steps-on-the-nbni-g-sifi-assessment-methodologies/ that the risk presented by the asset management was to be more adequately addressed through activities than entities regulations; it mentioned leverage and liquidity as the key components of potential risk for financial stability; we believe that this approach should be shared by BCBS and, clearly, it does not point towards prudential regulation for AM.

Second, Amundi's opinion about the way to approach step-in risk due to asset management could read as follows:

- The definition of step-in risk is not clarified and the vocabulary used tends to mix concepts that are relevant in some circumstances (like securitisation) and not for other activities, like asset management; we feel necessary to start with definitions and rewrite most paragraphs that intend to address Asset management.
- The consolidation of those activities that are usually made by banks is appropriate to avoid regulatory arbitrage; it applies to guarantees explicitly offered and confirmed liquidity lines; we consider that the possibility to extend the banking prudential requirements to seed money and investment in funds made by asset managers and other quasi financial entities should be investigated; we do not see any other activities that could be concerned.
- For entities that are consolidated within a prudentially regulated group, bank or insurance, these risks are already taken into consideration; other risks are consolidated as well under pillar 2 that are of relevance for asset management, in particular reputation and operational risks; we do not see why a further requirement should be introduced for step-in risk for asset management activities.
- We agree that a conversion approach is appropriate for those AM entities which are not already consolidated within a prudentially regulated group; if the AuM were to be considered as an adequate basis, and we see it is the easiest way to proceed, a very low CCF should apply, probably lower than 1% when considering the effective step-in risk and the strong mitigants that the AM regulations provides. Moreover, our understanding is that this 1% would be applied to the whole AuM and would represent a credit exposure equivalent and not a capital requirement. It should be more clearly stated.
- We do not share the view that an extra layer of step-in risk should be linked to banking activities like guarantees, as suggested in the last bullet point in §88; these activities are prudentially regulated and the same requirements should be extended whenever the counterparty is not a bank nor an insurer, but there is no risk to create step-in risk in relation to those activities which are well documented and disclosed to investors.

Third, we now turn to the questions of the consultation. Amundi intends to provide feedback on those points where its experience leads to strong views and will shortly comment or not answer those questions which are less central for AM.

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Q1. What are commenters' views on the four overarching principles? Are there any others that should be included?

Amundi wishes to comment the first and third principles. Starting from the situation after a step-in is ambiguous. It is certainly the most appropriate way to measure the impact of the step in risk to consider the situation when it has materialised. However, it overlooks the analysis on the probability of materialisation which is volatile and diverse. Furthermore, it implies that entities have no **power to resist stepping-in**, which is very far from reality. We know that going further than contractually agreed in terms of financial support is not the business model of banks and financial institutions. We believe that when stepping-in, they voluntary act with a view to better protect long term interest both for themselves and their clients. Contrary to the final sentence under principle 1, we judge that it is of foremost importance to **differentiate between temporary liquidity support and structural solvency support**. We fear that an undifferentiated approach could lead to disastrous uneconomical results. We suggest that BCBS further assess the different steps in a step-in process in order to build a proportionate approach properly calibrated at each step.

Amundi believes that proportionality, mentioned under principle 3, should be elevated to the rank of an independent principle. The reference to a conservative /prudent bias is explicit and the only mention of proportionality is to limit this bias and avoid "an unjustifiably disproportionate …manner". We suggest that BCBS explicitly refer to non- prudential regulations that are powerful mitigants of the risk for banks to step-in. In other words Asset management is not an activity where the risk of step-in is significant and it is **through the principle of proportionality that the impact of regulations specific to this activity could effectively be taken on board.** The present wording is not satisfactory in that respect.

Q2. What are commenters' views on the proposed indicators for step-in risk? Are there any additional ones that the Committee should consider?

First, **the concept of sponsorship is not relevant in the case of asset management**. As confessed in the consultation document it is used in the context of securitization and we know that it has some meaning there when referring to the origination, securitization and distribution process. The extension of the concept to the asset management industry is not appropriate : there is no originator and, in turn, no sponsor if we may return the phrase used in §45.

One should clarify whether the step-in risk can apply to an unintended support to the AM firm or to a fund managed by this firm. If it applies to the firm, the risk is minimal when considering the strict supervision of AM and the absence of risk taken on its balance sheet where a minimum capital amount has to be kept in cash. Moreover, the risk is taken into consideration when the AM is a subsidiary of a bank which will prudentially consolidate the balance sheet. If it refers to the fund, one should consider the constraints on concentration, liquidity and leverage for example that apply to funds and the absence of any implicit capital guarantee.

If we discuss the three elements listed in §46, we realize that none of them applies in case of asset management. Decision making in the management of clients portfolio is totally independent from the management of the AM and its mother company. The investment decisions are exclusively based on the best interests of the clients as a result of the fiduciary duty an AM owes to its client investors. Strong procedures to prevent conflicts of interests are in place and controls are regularly conducted by the compliance teams and the risk controllers within the firm. Furthermore, there is no capital link between the AM and the fund it manages, the money comes from clients and the power to decide investments is in the hands of the AM within the framework of a strictly regulated organization. The structure of the board is not an indicator of effective power in the management of clients' money.

The second element of the definition of a sponsor relates to **operations, i.e. placing securities** into the public. AM use distributors that place units of funds. Banking networks are among the most precious distributors for that purpose. In some countries the word of promoter is used to designate a distributor who will have a decisive role in the distribution of a fund, often when it is the exclusive distributor. In cases of open funds where there are many different distributors there is no risk of step-in, on top of the general (and highly diluted in this case) reputation risk.

We finally turn to **financial support , i. e. provision of liquidity facilities or credit enhancement**. Credit enhancement may refer in our industry (if not to securitization deals) to the guarantee that a bank offers to the holder of a fund to fully or partially guarantee the capital invested or a minimal performance. It has to be clearly documented and the prospectus of the fund will precisely disclose the guarantee and its limits, so that we do not see any room for step-in risk. The provision of liquidity is not a substantive issue either, since holders are aware that the liquidity of the fund is consistent with the liquidity of the assets it invests in. The management of the liquidity is part of the job of the AM and has always been. The higher volatility of many markets and the recent and drastic reduction of market making activities have not favoured the liquidity. This has lead large AM to negotiate confirmed liquidity lines to be in a position to call on them if necessary. It underlines the fact that responsible entities have taken decisions to have clear explicit solutions in case of tensions and reduce the step-in risk. More generally on that point, we insist that a temporary liquidity support does not amount to step-in.

Second, Amundi opposes the example under number 10 whereby an external rating for an AM based on a bank's own rating and implicit support would be a primary indicator of step-in risk. We are appalled to see that regulators would be keen to **totally rely on external CRA's analysis to decide**. The recent history has shown the disastrous consequences of overreliance (and exclusive reference is one of its aspects) on CRA's opinion. It would amount to delegating a regulatory power to CRAs and we cannot but strongly oppose it. We would agree to see it mentioned as a secondary indicator, though.

Third, when considering example 5, we are surprised to see that there is no difference whether the presumed sponsor has or has no decision making power, offers total or partial upfront facilities and is or is not majority or only provider of facilities. We think that the presumption in example 5 is so feeble that it should not be included in this list. With primary indicators the presumption will be difficultly rebuttable, since the only way (cf.§ 47) is to show that mitigants are present (which is impossible to evidence when there is no explicit risk to mitigate). We believe that even primary indicators should be largely open for discussion and that **the wording in §47 is too restrictive** in that respect.

Q3. What are commenters' views on the proposed secondary indicators for step-in risk? Are there any additional ones that the Committee should consider? Should any of them be considered as primary indicators?

We think that the list is somehow redundant and that a more detailed analysis would help limiting the number of secondary indicators and focusing on most relevant factors. We acknowledge that many of these indicators do not apply to asset management, especially when they refer to terms such as "sponsor" or "originator".

Amundi is more concerned with indicators h, j, k and l. Indicator (h) starts on an assumption which is not realistic. **Providing inadequate information is a breach of the law** as far as asset management is concerned and we do not think that it makes sense to include such a circumstance in the list of secondary indicators. It is a breach of the law and as such part of the operational/conformity risks of the firm. The same applies to (j) where the **appropriateness and suitability tests under MIFID make it impossible** to sell a product to a client who is not capable to bear a loss when it appears. We strongly disagree with the rationale behind indicator (k). An investor in a fund bears the risk of liquidity as well as the risks of performance and volatility. Liquidity rules are disclosed in the prospectus and exceptional circumstances allow for the use of specific tools that can go as far as suspension of redemptions. The principle in the asset management is the **equality among unit holders** and it does not allow for any derogation. We suggest that these 3 indicators be removed from the list.

With regard to indicator (l), Amundi agrees that the **disclosure of unconsolidated entities required under IFRS12** might provide regulators with substantive information. We think, however, that it is of foremost importance to keep it as a **secondary indicator** that is not immediately conclusive. In effect, we know that the current practice can differ from one country to another, from one entity to another in terms of scope of these entities that are not consolidated and that are subject to IFRS 12 disclosure requirement.

Q4. What are commenters' views on the different potential step-in risk assessment approaches? Are there any other approaches that the Committee should consider to account for step-in risks?

We do not see many cases where the asset management industry will be a case for step-in risk. For the few instances where it may appear we are convinced that the **Conversion approach** is the only reasonable one for AM, due to the legal definition of responsibilities of the investor and the asset manager. This strict and clear framework leads to the conclusion that the most appropriate coefficient will be very low, very close to zero actually. We understand that the 1% figure, which we consider as too high, is a way to define the basis for applying a ratio of required capital not the level of capital requirement itself.

Q5. What are commenters' views on the proposed mapping between the primary indicators and the potential approaches?

For asset management we do not see any alternative to a conversion approach, though we believe that there is no need for any capital requirement in most cases. This is consistent with the suggestion of the document when there is no decision making by an entity on the other one.
We understand that the 1% figure which is mentioned further below in the consultation is a way to define the basis for applying a ratio of required capital not the level of capital requirement itself.

Q6. What are commenters' views on proportionate consolidation for joint-ventures?

No comment.

Q7. What are commenters' views on risks stemming from banks' relationships with asset management activities and funds and the appropriateness of the direction envisaged?

We hope that we have made it clear that the asset management industry does not compare to banking nor insurance. An asset manager has a limited balance sheet and a capital that covers the limited operational risk linked to the agency activity it conducts. A prudential regulation that would introduce minimum capital requirements is not adequate, except for those activities that are usually made by banks.

When reading §86 in the consultative document, we are not convinced that the proposed indicators will help identifying those situations where there might be a step-in risk in asset management activities. Three possibilities are listed:

- to support an unconsolidated asset management company: it is highly improbable that an AM company will need support as it acts as a pure agent and does not engage in prop trade;
- to support unconsolidated funds: it is highly improbable as well, since funds are separate entities with holders aware of the risks they take (and the return they expect); any guarantee is explicit, documented and disclosed so that there is no room for step–in risk ;
- or both: which is not less improbable in our view.

This applies to both credit enhancement (and we believe that it can only refer to guarantees of performance) and provision of liquidity (and we believe that asset managers have a sufficient tool box to address liquidity issues without stepping in). Please see our answer to question 2 above.

We feel that §87 is more specific to AM activities and we are keen to comment it and provide some more realistic examples of situations we experiment in the EU.

BCBS is right to point out that when a **guarantee** of capital or performance is granted by an asset manager it should be covered by prudential regulation. In Amundi's experience, performance or capital guarantees are offered by banks subject to banking prudential regulation. From a commercial point of view any other type of guarantee does not bring the same level of comfort to potential subscribers. In several countries it is a regulated activity that can only be carried by licensed and supervised banking entities. We support the idea that provision of guarantee be made by banks and that if made by other firms those must be prudentially regulated. We strongly disapprove of any side letter (signed to offer clients some protection on the price movements) which would not be considered as a guarantee and would not be subject to prudential banking regulation.

There are circumstances when the asset manager or the distributor spontaneously indemnifies a client. It is not based on the recognition of any responsibility, but it is made as a commercial gesture towards a client who, though not in a position to introduce a strong legal procedure, complains and asks for repair. This type of **commercial arrangement** to keep a client happy belongs to the operational/reputation risk. Under pillar 2 they are estimated and covered in the banking prudential regulation. As we mentioned, Amundi is subject to this regulation because of its status as Etablissement de credit and as a subsidiary of G-SIFI bank Crédit Agricole; it is consolidated and its reputation and operational risks are included in CA reporting. We consider that it is important for asset managers to be able to face such incidents. Again, we strongly disapprove of any side letter which would enable avoidance of prudential banking regulation.

BCBS further mentions the case of a bank having directly or through an AM subsidiary a relevant interest in the fund other than management fees. A bank may be a regular **counterparty** of a fund managed by a linked asset manager. However, fund managers are due to ensure best execution of their deals, and if the bank is a counterparty it is on the basis of its quality of execution. Furthermore, client investors benefit from a large disclosure on the counterparties of a fund, as a means to reduce or manage potential conflicts of interests. The hypothesis in the paper is a bank which would be tempted to extend undue support to a fund in which it has a real interest. We do not believe that **loan to the fund** is a realistic case of step–in risk with UCITS and AIFs who do not use significant leverage. It may concern hedge funds in their relationship with their prime broker, which is an area of specific attention for regulators *per se*, without having to refer to step-in risk. We can mention **seed money** provided by a mother company to a fund at the time of its launch. It is common practice for an AM or its mother company to invest in a fund and keep the position as long as the AuM is not sufficient from a commercial point of view. It is common practice to hedge the main risks of the investment strategy in order not to put the fund seeder at risk. In Amundi's view, investment made in a fund should not be penalized nor favoured. It should be considered as any investment with an appropriate level of own capital requirement.

With reference to **money market funds** (MMFs), which have been from the start pointed out as presenting a risk for financial stability, the document acknowledges that the proposed European regulation on MMFs intends to ban any support by the promoter. As a consequence there would not be any residual step-in risk on behalf of MMFs. We want, however, to stress the intrinsic difference between CNAV and VNAV. The risk of run materialized in the US with CNAV funds. No such difficulties appeared in the EU with VNAV MMFs. CNAV MMFs are sold as substitutes for deposits and not as investment funds presenting valuation risks. The amortised cost valuation enables a CNAV fund to publish an official NAV of 1$ as long as the shadow NAV is above 99.5 cents. This valuation gap between published NAV and market value creates a first mover's advantage that incentivizes unit holders to escape away from the fund before its NAV breaks the buck and shows a 99 cents figure. On the contrary, a VNAV MMF will publish the market value of its assets and its NAV will progressively decline so that redeemers of units will lose money in the same proportion as if they kept their holding. The fund may sell its positions at market price, which happens to be valuation price, without prompting a further decline in price. Thus, VNAV can create liquidity through sales. We believe that if any consideration should be paid to the risk of run on MMFs it should very much differentiate between CNAV and VNAV.

In conclusion, Amundi's opinion about the way to approach step-in risk due to asset management could read as follows:

- The consolidation of those activities that are usually made by banks is appropriate to avoid regulatory arbitrage; it applies to guarantees explicitly offered and confirmed liquidity lines; we consider that the possibility to extend the banking prudential requirements to seed money and investment in funds made by asset managers and other quasi financial entities should be investigated; we do not see any other activities that could be concerned.
- For entities that are consolidated within a prudentially regulated group, bank or insurance, these risks are already taken into consideration; other risks are consolidated as well under pillar 2 that are of relevance for asset management, in particular reputation and operational risks; we do not see why a further requirement should be introduced for step-in risk for asset management activities.
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- We do not share the view that any extra layer of step-in risk should be linked to banking activities like guarantees, as suggested in the last bullet point in §88; these activities are prudentially regulated and the same requirements should be extended whenever the counterparty is not a bank nor an insurer, but there is no risk to create step-in risk in relation to those activities which are well documented and disclosed to investors.

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