Amundi
ASSET MANAGEMENT

Amundi's response to BCBS Consultative Document Guidelines Identification and management of step-in risk

(May 15, 2017)

Amundi is the leading asset manager in Europe and will improve its position in the top 10 worldwide after completion of its merger with Pioneer. Assets under management will then exceed 1.3 trillion €. The current presence of Amundi in 30 different countries servicing 100 million retail clients and 1000 institutional clients will be further diversified and reinforced. Amundi is fully dedicated to providing efficient investment solutions tailored to the needs of its clients.

Amundi is a listed company with Credit Agricole as its majority shareholder. As a consequence Amundi, which includes licensed banks and investment firms in its own group, is prudentially consolidated and subject to banking regulation.

Amundi supports the development of regulations that enhance market stability allowing for a better financing of economic activities and, hence, sustaining growth and employment. We are proud that asset management, as an industry, participate to this objective through channelling savings towards productive investment. We protect investors interests through an efficient risk management that enables clients to adjust their financial investments to the risk level they are able to face and to optimise the corresponding return. In this general framework, Amundi has a clear view that **bank-like activities must be identically covered by the same prudential requirements, irrespective of the nature of the actor** which conducts them. This applies for asset management when there are guarantee, market making, lending agency, financing or sponsoring activities run from their balance sheet and not on behalf of client investors or funds. Operational risk is also within the scope of this **need for level playing field** and appropriate prudential measures.

Answering the December 2015 consultation on step-in risk, Amundi expressed the concern that the true nature of asset management might not be properly understood and feared that regulators might engage in the inadequate route of copying banking regulation. After reading the present consultation document we are satisfied and thankful to BCBS because **the originality of the asset management business model seems to be properly considered.** The asset manager is an agent acting for the benefit of the client investors who entrust it with their money. Risk can only be assessed at the level of the end client who bears it.

Our response will address only some sections of the presentation.

1. Introduction:

Amundi agrees with the approach of the Guidelines to consider the framework as **a "safety net"** to better address the risk within the existing regulation. It comes as a supplement that might be without impact in many cases and helpful in some when specific circumstances justify a better attention to step-in risk. Positioning the step-in risk in Pillar 2 confirms the responsibility of the declaring bank and the necessity for it to convince its NCA on its analysis of residual risk post mitigation measures. We think that it is consistent with the existing supervisory and risk management procedures. We also support the application of **proportionality** when placing out of scope entities that may create step-in risk in an immaterial way.

An asset manager like Amundi who is included in the scope of banking prudential regulation is attentive to properly assess the risk it bears in solo and it may create for other entities within the group. The Guidelines will help improving the formalisation of the process under Pillar 2, but we do not consider they will introduce major changes. As a matter of fact, market risk is borne by investors in funds or managed portfolios and **the management company may suffer only from operational dysfunctions**. The mother bank might be impacted twofold : as any other investor if it holds units of a funds and as ultimate recourse as shareholder of the management company if it faces difficulties.

2. Definition and scope:

If we agree that step-in risk is part of reputational risk, we consider that it is intimately linked to operational risk. The distinction might be clear for banking regulation specialists, but it is not that clear-cut for other industries and for the public at large. When reading the definition of operational risk in §16 we can find reasons to consider step-in risk, though a kind of reputational risk, as a subcategory of operational risk: there is an inadequate internal process that leads the bank to support an entity more than contractually defined and this may have an external influence on the partners, clients or finance providing entities of the bank. We think that it would be helpful to distinguish **two levels of operational risks**: the banking definition of operational risk *stricto sensu* that would exclude reputational risk and the general concept of operational risk that would include those risks that are not linked to markets (market, credit, liquidity or counterparty risks).

The first step is to identify entities that need to be assessed. Amundi shares the view that:

- accounting and regulatory consolidations are the first and major indicator for assessment;
- securitisation should be assessed, but it does not mean that the conclusion will necessary be of the existence of step-in risk;
- commercial entities as well as insurance regulated entities will be out of scope; we suggest that **regulated funds be also out of scope**;.
- A materiality test should be conducted to exclude entities with minimal potential impact on the capital or the liquidity of the declaring bank;

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- national law should be taken into consideration when it prohibits a bank supporting a defaulting entity or severely reduces the ability of the bank to step–in.

On this last point, Amundi expects regulators to take stock that MMF Regulation prohibits any sponsorship for MMFs. As soon as the law is implemented MMFs will no longer be subject to any step-in risk and will not need to be assessed in that respect. We would like banking authorities to analyse the consequences of MMFR not only in the field of step-in risk but also and urgently in terms of LCR where investment in MMFs should be considered, totally or with a limited haircut, as high quality liquid assets (HQLA). With regard to NSFR regulators should reassess to which extent short term funding provided by MMFRs to banks can be considered as stable.

When considering shadow banking activities and more specifically the indicative list in Annex 2, Amundi does not agree with the qualification of funds as shadow banking activities. Please refer to our specific comment below of Annex 2.

3. Identification of step-in risk:

Amundi considers that there are only a few criteria of the list that apply to funds. It does not come as a surprise, since asset management is a closely supervised and tightly regulated industry. Actors (asset managers), products (UCITS, AIFs), activities both on the financial (market exposure and risk management) and the marketing (distribution and investor protection) sides are regulated. We maintain the view that UCITS as well as AIFs that do not use important leverage (net exposure lower than 3) do not present systemic risk and should not be part of shadow banking. **We recommend Basel Committee to include UCITS and AIFs not using substantial leverage among those entities that are exempt from step in risk,** following the materiality test that constitutes the second step of *the structure of the framework* in section 1.4.

We agree that there is no exhaustive list of factors that would prove step-in risk. We share the view that the converging presence of several indicators will require a more in depth analysis to determine the possibility of step-in risk. Let us quickly comment on the items listed by the BCBS from an asset management firm's point of view and **suggest amendments to examples and counterexamples** (*noted in italics*) :

- Sponsorship/ implicit support/ reputational risk/ historical dependence: decision making power in funds and mandates is in the hands of the asset manager who uses it to the best interests of the investor in the limits determined in the investment policy/strategy. Independence in the decision might not prevent from implicit support for commercial reasons and particularly in case of reputational risk. However rules to prevent, disclose and manage potential conflicts of interests have developed to such an extent in recent years that historical step-in would probably not be possible today and should not be considered blindly as an indicator. *We suggest that a reference to asset management be included in §40 to underline that banks have no say in the decision making on funds; we further believe that the first example in §42 reintroduces a disproportionate impact of external ratings and should be deleted.*

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- Structured entities : heavy leverage is not a characteristic of asset management, except for hedge funds. Moreover, structured funds must be designed in such a way that investors do understand their components and market sensitivities. Asset management industry is not concerned under this criterion.
- Liquidity stress : as noted by FSB in its recommendations on vulnerabilities of asset management a set of effective tools is now available to asset managers to control redemptions and drastically reduce the potential for first mover's advantage. The second example in §47 underlines that runs only appeared on CNAV money market funds where the opacity around the discrepancy between market value and funds constant NAV was the source of the problem. It is largely cleared with MMFR in the EU whereby transparency on market value has to be provided. We agree with counterexamples in §48 that show that most mutual funds will benefit from a presumption of absence of step-in risk under this liquidity approach.
- Transparency /accounting disclosure/ alignment : legal and marketing documentation for funds and mandates is designed to fully inform investors prior to their decision and regularly during the time they hold their position. The requirement for clear, true, complete and understandable information is of paramount importance in UCITS, AIFMD, PRIIPs or MIF legislations. MIF2 requires further tests of appropriateness and suitability that prevent any "mis-selling" and misalignment with investor's risk profile. It now extends to all categories of client investors. *The first example in §56 seems highly theoretical when the counterexample in §57 applies to the marketing of all funds and mandates; we suggest to withdraw the first and include funds and asset management to illustrate the second.*
- Regulatory mitigants : there are so many regulations (each with its own reporting) applying to asset management that we trust investors are really protected and step-in risk is very limited in the industry. The only remaining risk is fraud since *fraus omnia corrumpit* and it is addressed with adequate procedures and controls. *We believe that MMFR that prohibits any support should be mentioned as another example in §65.*

In summary, **Amundi concludes that most asset management activities and entities will be out of the scope of potential step-in risk** with the exception of some hedge funds and possibly a few mandates or funds where the commercial involvement of the promoter is exceptionally high and may justify stepping-in as a way to avoid reputational damage.

4. Potential responses to step risk:

The step-in risk linked to asset management being very limited, the question of potential response should not be a concern for the industry. We, thus, do not agree with responses on step in risk management foreseen in section 4. However, we would like to introduce the following comments to clarify important issues on measures we do not support :

- Consolidation is already implemented when an asset manager is part of a banking group and we think that it is a fair practice for pillar 2 issues related to operational risk in a broad sense. As a matter pf level playing field, we believe that **this approach towards operational risk and bank like activities could be extended to**

other asset management groups and included in a specific framework for independent firms. With reference to §71 we further consider that past comportments will not repeat themselves since mitigation measures have been introduced and justify an examination of the effective risk as of the day of assessment.

- Conversion must be flexible to adapt to different circumstances as pointed out in the document §78. However the mention of the total balance sheet of an entity to which a conversion factor would apply is not appropriate for asset management; **there is no relationship between size of assets under management and effective risk** which depends on the quality of internal procedures and their effectiveness for all investment strategies developed ; only **very granular conversion factors** could be appropriate and they should take into consideration the organisation of the firm as well as the investment universe and the specific strategy of the portfolio. In short, implementation seems overly burdensome compared to expected benefits.
- With respect to targeted measures, we have a strong belief that it would be counterproductive and **dangerous to disclose** confidential information on assessment made by banks on potential step-in risk. The risk of self-fulfilling prophecies is very high and implicit support may be considered as explicit based on the fact that it is foreseen as a possibility, thus **increasing moral hazard**.

5. Annex 2:

In Annex 2 EBA lists 6 structures that are usual instruments for asset managers to run : REITs, Mutual funds, MMFs, ETFs, Hedge funds and Private equity funds. We think that among them **Hedge funds are the only ones who can present step in risk** due to their higher dependency, for some strategies, on banks.

In the European Union mutual funds are all subject to investor protection rules that (i) impact their investment policy through investment restrictions and diversification ratios and (ii) demand a strong risk management and valuation policy. This is true for MMFs that are now tightly regulated (with a ban on any type of sponsor’s support) and ETFs that cumulate regulations applying to funds and listed entities. **Transparency is a key word for funds and it is difficult to consider they can belong to shadow banking**.

REITs and Private equity funds do invest in **illiquid assets** whose valuation cannot be determined with accuracy on a daily basis. But they offer a clear opportunity for investors to capture an illiquidity premium and they have statutory provisions restricting subscriptions and redemptions frequency. They do meet the needs of clients that are ready to hold positions for long. Limitations on leverage is the key factor to avoid banking like activities being conducted by these funds : they exist and reduce risk of difficulties, and hence step-in risk, to a marginal issue.

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