

28/06/16

Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: Revisions to the Basel III leverage ratio framework

Paris, 6 July 2016

Dear Sirs,

AXA Investment Managers (AXA IM) is glad to comment on the Basel Committee on Banking Supervision consultative document regarding revisions to the Basel III leverage ratio framework.

AXA IM is global in many senses: close to € 700 billion of assets under management¹; 26 locations (including 14 locations in Europe); over 4,700 clients; 1,700 funds and mandates. AXA IM also employs a skilled staff of more than 2,300 employees originating from 59 different nationalities.

From a European perspective, AXA Investment Managers is ranked in the top 5 EU-headquartered asset management companies.

AXA IM is also a global asset management company by the diversity of its competencies.

Our management of investments - exclusively on behalf of clients - illustrates our aim of financing the economy.

¹ € 669bn as of end of December 2015

Introduction:

Since the 2008 financial crisis, regulators across the globe put in place a very large number of rules to make the financial system safer and ensure taxpayers will never be solicited for bailing out a failing or distressed financial institution. In our capacity of asset and derivative manager for long term investors, our objective is to maximize investment returns while protecting the capital invested and managing part of the ALM financial risk of our clients and so we welcome the will to strengthen the financial system as a whole.

With these new legislations and especially Basel III, bank balance sheets will be strengthened and the financial investment portfolios we manage to the benefit of our clients and especially insurance companies and pension funds will probably benefit from a better credit quality. Yet, as it is written today, the legislation will also have several negative impacts on the way long term investors will invest and manage their risks.

The issue comes with implementation details - not with the principle of regulation. Leverage ratio treats differently bond or cash collateral, penalizing bond holders in a very significant way.

Revision to the treatment of derivative exposures:

1) Recognition of government bond collateral

AXA Investment Managers mandates for insurance companies and pension funds are composed mainly of high quality bonds (government bonds and corporate bonds) and diversification assets such as high yield bonds, loans, real estate or equities.

A key complement to these bond portfolios is the risk mitigation management through repo and derivatives, which we use to manage the duration gap and other ALM issues particularly key to our client objectives (in particular under Solvency insurance and pension legislations). So bonds are key to our mandates and derivatives are an essential component of the risk management process of our clients.

Yet under current BCBS LR standards regarding derivative transactions, government bonds will not be any more eligible in collateral agreements for our non-cleared OTC hedging books. As it stands today and in proposed revision, LR apply penalties to non-cash collateral OTC derivatives.

We used to have liquid government bonds accepted as collateral by our counterparties. But nowadays, LR legislation deems those government bonds of no value when assessing the impact of our collateral agreements. Those liquid and high quality assets will not be accepted anymore as collateral and we will be forced to move to cash collateral.

LR legislation will then force us to do an intermediary repo transaction to source cash collateral (thus creating an exposure to the risk of closing of the repo market).

Ultimately we are providing cash and liquidity to banks while they have no need for such liquidity, as they have access to central bank liquidity facility - and we will bear a systemic risk on the closing of the repo market.

LR do not recognize long term liquidity value of government bond collateral for insurers (not even with haircuts) while at the same time LCR does recognize the short term liquidity value of the same bonds for banks.

We do believe that government bond collateral, and related settlement cycle, should be recognized for the purpose of calculating LR, in order to avoid penalizing significantly long term investors.

In addition, we are worried that proposed revision limits further collateral recognition by imposing an variation margin exchange condition such as “variation margin *[is to be]* exchanged on the morning of the subsequent trading day based on the previous, end-of-day market values”. Such condition, that may already be hardly achievable on large number of funds and mandates, in particular between counterparties having different time zone, is strictly impossible for government bonds with T+1 or T+2 settlement cycle.

2) Recognition of IMs as reducing derivatives exposures

Potential losses and replacement costs related to derivative transactions are already secured by collateral arrangements and shall be subject to Initial Margin (IM) requirements under EMIR and Dodd Frank. Upon counterparty default, IM provided should be sufficient to cover the replacement cost of defaulted transactions and ensure a funding continuity between collateralized matched books.

We believe there is no need for additional capital to be required to secure transactions for which collateral and margins provided already cover counterparties default and replacement risks.

In addition, with respect to IM, we consider that cash should not be privileged over government bond collateral. Cash can never be segregated. Giving incentive to cash over government bond collateral would increase overall market exposure to banking risk. Both Dodd Franck and EMIR allow for IMs to be posted in government bonds, LR regulation should not implicitly restrict such capacity by applying more favorable treatment for cash.

As a consequence, we do believe that government bond segregated IM should be recognized for the purpose of calculating LR, in order to avoid penalizing significantly long term investors.

Proposed amendment (on revised version):

Basel III leverage ratio framework and disclosure requirements - Exposure measure - (b) Derivative exposures:

25. Treatment of cash **and Level 1 HQLA** variation margin : in the treatment of derivative exposures for the purpose of the leverage ratio **exposure measure**, the cash **and Level 1 HQLA** portion of variation margin exchanged between counterparties may be viewed as a form of pre-settlement payment, if the following conditions are met:

- (i) For trades not cleared through a *qualifying* central counterparty (QCCP) the cash **and Level 1 HQLA** received by the recipient counterparty is not segregated. **Cash and Level 1 HQLA margin would satisfy the non-segregation criterion if the recipient counterparty has no restriction by law, regulation, or any agreement with the counterparty on the ability to use the cash received (ie the cash and Level 1 HQLA variation margin received is used as its own cash).**

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(ii) Variation margin is calculated and exchanged on **at least** a daily basis based on mark-to-market valuation of derivatives positions. **To meet this criterion, derivative positions must be valued daily and cash and Level 1 HQLA variation margin must be transferred at least daily to the counterparty or to the counterparty's account, as appropriate. Cash and Level 1 HQLA variation margin exchanged on the morning of the subsequent trading day based on the previous, end-of-day market values on at least a daily basis, and according to the settlement cycle of such collateral, would meet this criterion, provided that it meets criterion (iv) below.**

(iii) The cash **and Level 1 HQLA** variation margin is received in the same currency as the currency of settlement of the derivative contract.

(iv) Variation margin exchanged is the full amount that would be necessary to **fully** extinguish the mark-to-market exposure of the derivative subject to the threshold and minimum transfer amounts applicable to the counterparty.

(v) Derivatives transactions and variation margins are covered by a single master netting agreement (MNA) between the legal entities that are the counterparties in the derivatives transaction. The MNA must explicitly stipulate that the counterparties agree to settle net any payment obligations covered by such a netting agreement, taking into account any variation margin received or provided if a credit event occurs involving either counterparty. The MNA must be legally enforceable and effective **(ie it satisfies the conditions in paragraph 4 (c) and paragraph 5 of the Annex)** in all relevant jurisdictions, including in the event of default and bankruptcy or insolvency. **For the purpose of this paragraph, the term "MNA" includes any netting agreement that provides legally enforceable rights of offset and a Master MNA may be deemed to be a single MNA.**

26. If the conditions in paragraph 25 are met, the cash **and Level 1 HQLA** portion of variation margin *received* may be used to reduce the replacement cost portion of the leverage ratio exposure measure, and the receivables assets form cash **and Level 1 HQLA** variation margin *provided* may be deducted from the leverage ratio exposure measure as follows:

- In the case of cash **and Level 1 HQLA** variation margin *received*, the receiving bank may reduce the ~~replacement cost (but not the add-on portion PFE component) of~~ the exposure amount of the derivative ~~asset by the amount of cash received if the positive mark-to-market value of the derivative contract(s) has not already been reduced by the same amount of cash variation margin received under the bank's operative accounting standard~~ as specified in paragraph 2 of the Annex.
- In the case of cash **and Level 1 HQLA** variation margin *provided* to a counterparty, the posting bank may deduct the resulting receivable from its leverage ratio exposure measure, where the cash **and Level 1 HQLA** variation margin has been recognized as an asset under the bank's operative accounting framework, **and instead include the cash and Level 1 HQLA variation margin provided in the calculation of the derivative replacement cost exposure measure** as specified in paragraph 2 of the Annex.

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Revision to the treatment of securities financing transaction exposures:

AXA Investment Managers mandates for insurance companies and pension funds are composed mainly of high quality bonds (government bonds and corporate bonds) and diversification assets such as high yield bonds, loans, real estate or equities.

Large part of the balance sheet of insurance and pension funds is composed of high quality government bonds. Such bonds are used for Repo for the purpose of managing independently interest rate and credit duration of investments. In practice, duration of most diversification assets is

lower than that of government bonds and insurance companies and pension funds are basically buying government bonds, fund cash with repo and use the proceeds to invest into shorter term high quality credit bonds.

The portion of balance sheet allocated to repo remains very limited - for instance ACPR evidences that historical share of the balance sheet of the 12 main French life insurers is below 3.5%² to be compared to ESRB figure of circa 15% for banks³ - and not subject to represent significant weight in the market.

In addition, mandates for insurance companies and pension are using repo on a directional way, lending high quality government bonds and receiving cash, with no netting needs compared to banks.

Banks acting as market makers benefit by nature of netting capacities granted by regulation while end users with directional position cannot net positions and are penalized for it.

Full impact on pricing which will limit our ability to manage our clients ALM needs and especially interest rate and risky duration .

Although repo is needed for the purpose of managing insurance companies mandates, overall repo volumes represented remain low. In addition, banks counterparty to insurance and pension fund repos have access to central bank liquidity. Granting a derogatory treatment for insurance company and pension fund mandates repo treatment would enable us to continue to manage in the most efficient manner the investment and duration risks of our clients while not generating systemic risk for the market.

Proposed amendment (could be restricted to insurance and pension fund mandates):

Basel III leverage ratio framework and disclosure requirements - Exposure measure - (c) Securities financing transaction exposures:

33. *General treatment (bank acting as principal)*: the sum of the amounts in subparagraphs (i) and (ii) below are to be included in the leverage ratio exposure measure:

- (i) Gross SFT assets recognized for accounting purposes (i.e. with no recognition of accounting netting), adjusted as follows:
- **excluding from the exposure measure Level 1 HQLA**
 - excluding from the exposure measure the value of any securities received under an SFT, where the bank has recognized the securities as an asset on its balance sheet; and
 - cash payables and cash receivables in SFTs with the same counterparty may be measured net if all the following criteria are met...

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We remain, our teams and myself, at your disposal for any further contribution, meeting or testimony on this topic. Please don't hesitate to contact Daniel Leon, Head of Client Solutions Development (daniel.leon@axa-im.com ; +44 207 003 1575), Amaury Boyenval, Head of AXA Solutions and Structuring Group (amaury.boyenval@axa-im.com; +33 1 44 45 78 64), Stéphane

² Source ACPR – Analyses et Synthèses – Suivi de la collecte et des placements des 12 principaux assureurs-vie à fin décembre 2015

³ Source ESRB - Occasional Paper September 2014 - Securities financing transactions and the (re)use of collateral in Europe

Janin, Head of Global Regulatory Development (stephane.janin@axa-im.com, +33 1 44 45 93 64) or myself (andrea.rossi@axa-im.com, +33 1 44 45 74 14).

Sincerely yours,

(signed)

Andrea Rossi
Chief Executive Officer