IRISH FUNDS INDUSTRY ASSOCIATION

Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002
Basel, Switzerland

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RE: Consultative Document (2nd) Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions

Introductory comments

The Irish Funds Industry Association (the "IFIA") is the industry association for the international investment fund community in Ireland. The IFIA represents fund managers, custodians, administrators, transfer agents and professional advisory firms. Ireland is a leading centre for the domicile and administration of collective investment schemes, with industry companies providing services to collective investment schemes with assets totalling in excess of €3.8 trillion, of this, almost €1.9 trillion in more than 5,800 funds are domiciled in Ireland and managed by over 450 asset managers from 50 different countries. The comments we make are generally made with reference to the European regulatory framework within which our industry operates.

The IFIA welcome the opportunity to comment on the second consultation paper from FSB/IOSCO on identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions (NBNI G-SIFI) particularly as it relates to the asset management and investment fund industry. As members of the European Fund and Asset Management Association we support and endorse their response at a European level, including the previous industry responses to the first consultation in 2014, but we note that many of the points raised by industry in response to the first consultation do not appear to have been taken on board by FSB / IOSCO.

The process for addressing systemic risks in the non-bank non-insurer industry should begin with an identification of the risks and then a consideration of policy measures which could be implemented to address the identified risks. These measures may or may not include designation, but it would be misguided to begin with an assumption that designation is the appropriate policy measure without first having determined and identified the risks that need to be addressed. In identifying the risks to be addressed in the non-bank non-insurer industry, it is not appropriate to adopt the approach applied to the banking sector by focussing on entities. In a markets environment focussing on entities will simply mean risks get moved around the system but will not address or reduce the risks. Rather the focus should be on the activities that are being carried out by these entities.

We have concerns about the methodology proposed in the consultation paper and question this, or indeed any proposed methodology, that is not based on rigorous empirical data and real events.

Similarly any materiality thresholds seem to be arbitrarily established without detailed disclosure of the research supporting these thresholds. We suggest that the reliance on size as a primary focus should not be a sufficient indicator in determining systemic entities. While the reference to leverage is helpful, the proposed threshold for private funds of USD 400 billion of Gross Notional Exposure (GNE) and the two options for traditional funds are arbitrary. Given the fundamental issue with GNE in measuring notional amounts with no offset for hedging positions, it would be more meaningful to follow a methodology such as the commitment approach (as outlined in the UCITS or AIFM Directive). This could also provide for consideration that UCITS funds which are subject to a general leverage restriction of 2:1 to NAV would in the first instance not be considered for further assessment.

We share the concerns expressed by others in the industry that the non-bank non-insurer systemic risk initiative appears to be led by banking regulators rather than by the entities specifically established to supervise and regulate the asset management and markets industry. This leads to a subsequent apparent lack of appreciation and understanding for the significant existing and recently enhanced regulatory framework that the asset management and funds industry are subject to, particularly in Europe.

We are also concerned that in the scope of the NBNI G-SIFI assessment only the impact of an entity failing on global financial systems is proposed to be measured. Consideration of the likelihood of an entity's failure is expressly excluded, despite the fact that this likelihood could at least be measured or estimated with more confidence than the potential impact. We therefore recommend that both measures should be considered by FSB/IOSCO rather than just one in isolation.

We understand the political imperative, via the G20, to identify NBNI G-SIFI entities, but any risk based analysis should include the wider investment ecosystem including the activities and practices of asset owners as well as those of investment funds or asset managers. We call for FSB / IOSCO to extend the timelines proposed in the consultation and to use this time to implement a rigorous evidence based analysis supported by robust empirical data, which takes into account the nature of the asset management industry and encompasses the already intense regulatory and reporting framework within which the industry operates. Recent enhancements to existing and pending regulations such as EMIR, AIFMD, UCITS V, MiFID II and specific money market fund regulations are all designed to address potential systemic issues and investor protection. These measures need to be given time to fully take effect and have their effects measured in a systematic way.

In addition to the general comments above we have provided additional information in response to a small number of specific questions below.

Investment Funds

Q6-1. Please explain any potential systemic risks associated with the financial distress or disorderly liquidation of an investment fund at the global level that are, in your view, not appropriately captured in the above description of each risk transmission channel? Are there elements that have not been adequately captured? Please explain for each of the relevant channels separately.

<u>The exposures/counterparty channel</u>

Of the potential channels outlined in the consultation, the exposures and counterparty channel possibly represents the most relevant method of transmitting risk to the global financial system.

Highly leveraged funds or highly concentrated funds with large counterparty exposures could transmit risk across the financial system. However, as previously noted, regulations recently introduced in Europe (such as European Market Infrastructure Regulation - EMIR) which require a large portion of OTC derivative transactions to now be moved to central clearing platforms, together with additional reporting, clear and harmonised margin requirements, and increased capital charges for banking entities (fund counterparties), play a significant role in reducing the potential to transmit systemic risk. The effects of these measures and others covering the asset management and funds industry do not appear to be fully taken account of in the consultation, neither does the consultation seem to make a factual analysis of the data and reporting which is now being generated by these regulations. While the paper talks about public and private funds and the regulations that might apply to either, including restrictions to leverage, it is worth highlighting that in Europe, public funds (UCITS) have clear and strict limitations on the leverage they can deploy. Also, private funds (AIFs) have clear guidelines on the detailed reporting that must take place for all AIFs with enhanced reporting for substantially leveraged AIFs (as defined per the AIFM Directive). These reports are sent to local regulators in the first instance and on to the European Systemic Risk Board, and are accompanied with the right of the relevant regulator to require the AIF manager to take steps to reduce any particular leverage if it is deemed to be a cause of systemic risk.

<u>The asset liquidation/market channel</u>

In the section of the consultation looking at the asset liquidation / market channel we believe FSB/IOSCO is correct to specifically mention open-ended funds, as investors in close-ended funds have no right to make redemptions during the life of the fund. There is little evidence of very large redemptions from open-ended investment funds over the past 20 or 30 years, and any significant redemptions are generally managed well by asset managers for whom liquidity risk management is a core competence. However, this is not to say that redemptions could increase at particular times in the future, the potential for large redemptions is increased during periods of market stress. We note in this context that several measures exist for European investment funds to mitigate and manage this risk. For example, UCITS have diversification requirements and may only invest in eligible assets, this includes a requirement to assess the liquidity of the asset to ensure the UCITS can meet its liquidity requirements.

Similarly AIFMD has requirements for the AIF manager to carefully assess and stress test the liquidity risk of the underlying portfolio and ensure there are liquidity management plans and procedures in place to manage any liquidity risk. The liquidity risk of any open-ended fund arises when the liquidity of the underlying portfolio is not compatible with the dealing frequency with which investors can redeem from a fund. Both UCITS and AIFMD have in place requirements to deal with this risk. Furthermore, if a situation were to arise where the liquidity of the underlying portfolio was not sufficient to meet redemption requests, additional measures (such as redemption fees, gates, temporary redemption suspensions etc.) could be invoked in order to manage or restrict redemptions in an orderly manner.

Asset Managers

We reiterate and support previous industry positions against the inclusion of asset management companies within the scope of this consultation. The failure of FSB/IOSCO to take full account of these points by continuing to reference the systemic nature of asset managers is, we believe, a shortcoming of the consultation.

Asset managers are fundamentally different from banks and other financial institutions in what they do and the function they perform, and are not a source of systemic risk. Asset managers are not the same as banking entities, they are not balance sheet lenders, nor do they offer insured deposits, or access liquidity from Central Banks. As such the transmission mechanisms outlined in the consultation are not applicable to asset managers.

Asset managers have a responsibility to manage investors' assets through a contractual arrangement, on an agency basis, with the investors' assets invested via a fund and segregated from the assets or balance sheet of the asset manager. The associated risks and rewards of a fund's investments are borne and shared by the investors of the fund and not by the balance sheet of the asset manager. Under both UCITS and AIFMD the assets of the fund are entrusted to a custodian for safekeeping and are segregated from the assets of the manager. Being segregated, the assets are not at risk in the case of a bankruptcy of the manager and any resolution or change of manager is assisted by this segregation.

There are many parties and regulated service providers that are involved in providing services to an investment fund. From an oversight and governance perspective the investment manager is only one entity acting on behalf of a fund, typically via an investment management agreement with the fund, put in place by the board of a fund. The board of directors of a fund have ultimate responsibility for the governance of a fund, including the oversight of the investment management agreement and the performance and fulfilment of this contractual agreement by the asset manager.

These fundamental points do not support the inclusion of asset managers within the scope of a defined NBNI G-SIFI.

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