AGA – n°4342/Div

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

Paris, 15 December 2014

AFG response to the FSB's consultation on
Strengthening Oversight and Regulation of Shadow Banking
Regulatory framework for haircuts on non-centrally cleared securities financing transactions

General comments

The Association Française de la Gestion financière (AFG)[1] welcomes the opportunity to answer to the FSB's consultation on the Regulatory framework for haircuts on non-centrally cleared securities financing transactions.

AFG would like to stress an important issue which is the way entities enter into these operations.

Our members do not conclude through their managed funds "Securities Financing Transactions" but **Efficient Portfolio Management Techniques** motivated by investors' best interest. We would like to remind that regulatory concerns around pro-cyclicality and leverage resulting from repo and securities

[1] The Association Française de la Gestion financière (AFG) represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. 600 management companies are based in France. AFG members manage 3,000 billion euros, making the Paris fund industry a leader in Europe for the financial management of collective investments (with 1,500 billion euros managed from France, i.e. 19% of all EU assets managed in the form of investment funds). In the field of collective investment, our industry includes – beside UCITS – the whole range of AIFs, such as: employee savings schemes, regulated hedge funds/funds of hedge funds, private equity funds, real estate funds and socially responsible investment funds. AFG is an active member of the European Fund and Asset Management Association (EFAMA) and of PensionsEurope. AFG is also an active member of the International Investment Funds Association (IIFA).

lending transactions are better tackled through (already existing) specific legislation such as the UCITS and AIFM frameworks in the EU that are aimed at capping excessive exposures via clear leverage, counterparty and issuer limits, via portfolio diversification requirements, as well as via prescriptions on the collateral quality that is key to securing Efficient Portfolio Management (EPM) techniques.

AFG agrees that a large flexibility should be given to counterparties in the choice of collateral, provided that appropriate collateral is secured. We also agree that high quality government securities bear a lower risk and a higher liquidity than other securities.

Haircut is considered as one type of requirement when assessing the counterparty risk. Our members believe the counterparties must have the choice either to effectively receive (or post) adequate collateral with haircut or to accept to carry (or create) an open counterparty risk; for example, UCITS that are allowed to have a 5% counterparty risk on a non-bank counterparty could use this ratio to accept that collateral and haircut be not posted entirely.

AFG strongly **opposes** the idea that **funds** (and their asset managers) should be submitted to **specific registration and reporting to enter in SFTs**; except for hedge funds, and in Europe that would mean Alternative Investment Funds with a substantial leverage, funds are strictly regulated, constantly monitored and closely supervised and do not present any systemic risk; they should be out of the proposed framework and supervisors should rely on already existing reporting.

AFG wishes to point out that, apart from their fiduciary duties vis-à-vis investors, investment managers further count on rigorous (both regulatory and internal) criteria for the selection of their SFT counterparties, as well as on equally rigorous requirements governing collateral quality. In our view, these "lines of defence" are largely sufficient to prevent the risks identified by the FSB from materialising and where a minimum haircut floor framework would complement only marginally.

AFG would like to stress **that mutual funds – as they are of low risk - should benefit as collateral from a haircut level depending on their investment strategy as defined in the prospectus** (and not be applied an unduly penalizing fixed haircut level of 10%).

Responses to the questions of the consultation document

Q1. Do you agree that the application of the framework of numerical haircut floors as described in Section 3.3 to non-bank-to-non-bank transactions will help to reduce the risk of regulatory arbitrage and would maintain a level playing field?

AFG strongly advocates that **funds should not be subject to numerical haircut floors** when lending or borrowing securities.

Indeed, AFG fully agrees with the idea that the primary motivation of a transaction is key to determine the scope of the proposed SFT regulation. We represent asset managers that participate to the securities lending business, always with a call provision. Our members are not looking for any SFT (Securities Financing Transaction) but use **EPM (Efficient Portfolio Management) techniques** to improve for instance their funds' returns.

It should be recalled that UCITS regulation strongly limits the re-use of received collateral and only AIFs that use substantial leverage may exceed a 3/1 leverage, and as a consequence they have special reporting requirements under AIFMD.

Using repos or securities lending is identical from an economical and risk perspective. The choice between these two techniques (repo, securities lending) is determined in opportunity and is based on legal or administrative reasons.

Q2. In your view, how significant is the current level of non-bank-to-non-ban transactions? Do you expect that level to increase going forward and why? What types of non-bank entities are, or could be, involved in such transactions?

As a first point, AFG would like to point out that non-bank entities – and **investment funds** in particular – that engage in SFTs usually transact with prudentially regulated bank entities which are out of the scope of this consultation.

However, there might be a tendency in the future to develop direct dealings between non-banks and use banks as intermediary and not counterparty. Asset managers will certainly consider it with a view to better protect their clients' interest as it is part of their fiduciary duty to ensure best execution.

Asset managers are very active in SFT. We recall that the asset management regulation does consider them not as refinancing activities but as Efficient Portfolio Management techniques.

Funds are strictly regulated, continuously monitored and closely supervised. Except for Hedge Funds, and in Europe they are considered as AIFs that use substantial leverage, funds do not develop leveraged strategies and are forbidden to have a risk exposure through borrowing or derivatives that exceeds 3 for 1 in capital (and even 2 to 1 for UCITS). All these funds should be exempted from specific minimal haircut requirements designed to limit refinancing and leverage.

AFG disagrees that mutual funds suffer an outright 10% minimum haircut when posted as collateral. Instead, we insist on them being considered according to their investment strategy expressed in their prospectus: main equities or debt instruments or composite. We believe that, except for leveraged hedge funds, funds are very low risk entities and should benefit from lower and not higher haircut requirements.

Q3. Do the approaches set out above cover all potential approaches in applying numerical haircut floors to non-bank-to-non-bank transactions? Are there any other approaches? If so, please describe.

Yes, our members do not see other types of approaches.

We would insist that, notwithstanding the chosen approach, the FSB and domestic supervisory authorities that are to implement the proposed framework guard a sufficient degree of flexibility by exempting certain "non-bank financing models that do not pose financial stability risks" from the proposed framework. This is the case for the EU regulatory regime applicable to UCITS funds and certain AIFs (that do not use significant leverage).

Q4. Please provide any comments you have on the strengths and weaknesses of the approaches set out above, as well as any other approaches you believe the FSB should consider. What issues do you

see affecting the effective implementation of numerical haircut floors for non-bank-to-non-bank transactions?

Our members favour the **entity based approach** globally, as it includes as a prerequisite a thorough examination of the concerned entity and a specific assessment of its contribution to systemic risk. In that respect we have a strong view that UCITS and AIFs that do not use significant leverage should remain out of the scope of a regulation on minimum haircuts. Funds and investment managers are subject to strict controls and transparent information obligations that are sufficient for supervisors to assess their activities. In terms of motivations, they do not use EPM techniques (or so called SFTs) to refinance their balance sheet since they are limited in their global exposure including through derivatives.

The entity based approach is also judicious as it allows an entity to actively manage its counterparty exposure. An entity may use its allowance in terms of counterparty risk exposure to accept limited collateral deposit. This grants a minimal flexibility in a world where regulations are not harmonized and enables an entity to enter in a transaction on almost competitive terms.

Q5. What forms of avoidance of the numerical haircut floors are most likely be employed for non-bank-to-non-bank transactions? Which of the proposed implementation approaches is likely to be most effective in preventing such avoidance?

AFG strongly believes that this regulation should address the entities that are currently not registered nor supervised. In this perspective, the entity based approach will be more efficient to trace them. Counterparties should only deal with entities that are themselves registered and effectively report their trades. That implies a transaction based approach to identify concerned entities and then an entity based regulation.

For well-regulated industries, like that of investment management, numerical haircuts represent only an additional "line of defence" behind other more important risk management measures aimed at ascertaining the proper credit quality of the counterparty, as well as the quality of collateral.

Q6. If different entity-type regulations are used, do you see the need to ensure comparative incentives across different entity types? If so, please describe any potential mechanisms that may help ensure comparative incentives across entity types?

Especially from a risk point of view, our members believe that the key criterion to decide any scaling up in the regulation should be the effective leverage of the entities, not their legal nature nor the absolute amount of their positions.

Q7. If market regulation is used, should the FSB consider setting a materiality threshold of activity below which entities do not need to register? If so, what could be an appropriate level for such a threshold?

We would like to recall that **the preferred approach should be the entity approach** and not a market regulation.

In the case a transaction based approach would be taken, we consider a threshold is necessary so that asset managers and funds being registered, prevented to have high leverage and required to publish extensive reporting should be exempted from registration and specific reporting.

Q8. Do you see the need for a phase-in period in applying numerical haircut floors to nonbank- to-non-bank transactions, and if so how long should it be and why? Does the appropriate phase-in period vary depending on which approach is followed? Should it vary by jurisdiction based on the size and importance of the non-bank-to-non bank sector or should it be consistent across jurisdictions?

AFG believes that a phase in period in relation to related pieces of legislations that are being implemented progressively is unavoidable, especially for such deep and wide type of changes. In Europe, currently there is progressive implementation of the European Markets Infrastructure Regulation (EMIR) concerning the regulation of OTC derivatives, central counterparties and trade repositories. AFG thus strongly advocates for a comprehensive and coordinate global picture, where any standard haircut is closely linked to the collateral it applies to and related pieces of regulation follow an identical pace for implementation.

If you need any further information, please don't hesitate to contact myself, at +33.1.44.94.94.06 (e.pagniez@afg.asso.fr) or Adina Gurau Audibert, at +33.1.44.94.94.31 (a.gurau.audibert@afg.asso.fr).

Sincerely Yours,

Eric PAGNIEZ