Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities

Financial Stability Board consultative document

Joint response PMT/PME/MN

Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities

Introduction

This position paper is the joint response of the Pension fund for Metalworking and Mechanical Engineering (PMT), the Pension fund for the Metal and Electrical Engineering Industries (PME) and their service provider MN to the consultative document from the FSB on Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities. PMT, PME and MN support initiatives by the FSB to enhance the stability to the global financial system, in particular within asset management and banking.

Key messages

PMT, PME and MN want to provide several key messages/advise:

- Increasing the excellent work and initiatives on effective cooperation and coordination between (supra) national authorities / legislators.

Especially on data gathering from market participants and monitoring systemic risks across all financial sectors holistically (asset management, banking, insurance). Try to avoid legislation solely focused on single (one dimensional) measurement developed by a single authoritative / legislative body.

- Apply "in depth"- views on leverage and liquidity measures.

Ensure to have knowledge on the purpose and use of leverage from the (pension) fund manager (i.e. return enhancing or risk reducing). Furthermore strive to disseminate this knowledge across authorities and legislators.

- Awareness that too much regulation may cause a rigid and illiquid market.

A rigid market may prove not to be resilient in times of crisis. Therefore, to avoid a rigid and illiquid market there is a need of constant (rapid) adjustment of regulations.

- Investigate unintended high liquidity requirements for pension funds

Due to new banking regulation (Basel III Net Stable Funding Ratio and Leverage Ratio Framework) and market infrastructure regulation (EMIR, Dodd Frank, etc) combined with low competition levels in the clearing market, high liquidity requirements arise for end users causing probably systemic risks in the future and jeopardizing adequate old age pension.

The role of pension funds

With regard to alleged potential risk posed by certain types of pension funds, as described by the FSB, we would like to state the following:

- Pension funds distinguish themselves from other players on the European financial markets, in the sense that they do not add additional risk to the financial system. On the contrary, pension funds add to financial stability due to their rebalancing policies for the investment portfolio.

- Moreover, as highly creditworthy institutions, pension funds have limited short term liquidity needs, which makes them more inclined to buy and hold (cross-border) assets across the economic cycle. This contributes to financial stability and the resilience of financial markets as a whole.

- In addition, pension funds respond differently to macroeconomic risks in funded systems because members generally cannot withdraw their funds or assets on short notice, allowing for a more stable funding basis. Proposed policy recommendations by the FSB designed to enhance financial stability should take into account the role of pension funds as investors in the real economy.

We understand and support the essential steps taken by the FSB since the financial crisis to increase the stability of the global financial system. However, a large number of regulations which are targeted at regulating systemically important institutions on the financial markets, also have impact on pension funds and their members. Directly, because pension funds are regarded as financial institutions which fall within the scope of financial regulation, resulting in highly increased (reporting) requirements and operational costs. And indirectly, because of the risk that counterparties and intermediaries pass on the costs of increased capital requirements to end users such as pension funds. Ultimately, this leads to lower returns on investment and jeopardizing adequate old age pensions.

Background

The asset management industry has experienced strong growth in assets under management over the past decade. Because of this current size it is important to ensure that any financial stability risks associated with the asset management sector are properly understood and well addressed. Due to this need to understand and address potential financial stability risks from structural vulnerabilities associated with asset management activities, the Financial Stability Board (FSB) started investigating these vulnerabilities in March 2015 and reviewed their findings in September 2015. The initial findings and a list of five (vulnerability) areas were published.

1. Mismatch between liquidity of fund investments and redemption terms and conditions for fund units;
2. Leverage within funds;
3. Operational risk and challenges in transferring investment mandates in stressed conditions;
4. Securities lending activities of asset managers and funds;
5. Potential vulnerabilities of pension funds and sovereign wealth funds (SWFs).

In January 2016 the Pension fund for Metalworking and Mechanical Engineering (PMT), the Pension fund for the Metal and Electrical Engineering Industries (PME) and their service provider MN published a position paper on the systemic importance of pension funds[1] as a response to the FSB and IOSCO consultative document on assessment Methodologies for NBNI G-SIFIs.

In the position paper PMT, PME and MN argue that pension funds have a broad range of policy measures at their disposal to prevent insolvency and should not be regarded as Global Systemically Important Financial Institutions or treated as such. Also, pension funds can't go into disorderly failure, are not directly globally interconnected and are restricted from the application of high levels of leverage. For these reasons, they pose low risk to global financial stability and the wider economy.

Furthermore, PMT, PME and MN encourage the FSB to focus on institutions whose distress or disorderly failure may cause a significant disruption to the global system in order to address potential systemic risks within the financial system and reduce moral hazard.

In the current consultation document, issued on 22 of June, the FSB addresses four structural vulnerabilities from asset management activities:

1. Liquidity transformation by investment funds;
2. Leverage within funds;
3. Operational risk and challenges in transferring investment mandates in stressed conditions;
4. Securities lending activities of asset managers and funds.

[1] PMT, PME and MN, 'Systemic importance of pension funds', http://www.mn.nl/media/1405/position-paper-systemic-risk1.pdf.

Joint response PMT, PME and MN to the FSB consultative document – Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities

Q1. Does this consultative document adequately identify the structural vulnerabilities associated with asset management activities that may pose risks to financial stability? Are there additional structural vulnerabilities associated with asset management activities that the FSB should address? If there are any, please identify them, as well as any potential recommendations for the FSB's consideration.

We have responses stated below on each of the proposed policy recommendations in the consultation document.

Furthermore, we would like to stress that there are currently indirect unintended effects from proposed banking regulation (Basel III Net Stable Funding Ratio and Basel III Leverage Ratio Framework) and derivatives regulation (EMIR). These new regulations cause liquidity and concentration risks for the asset management/pension fund industry, which could pose a systemic vulnerability in the future.

Q2. Do the proposed policy recommendations in the document adequately address the structural vulnerabilities identified? Are there alternative or additional approaches to risk mitigation (including existing regulatory or other mitigants) that the FSB should consider to address financial stability risks from structural vulnerabilities associated with asset management activities? If so, please describe them and explain how they address the risks. Are they likely to be adequate in stressed market conditions and, if so, how?

We have comments stated below on the proposed policy recommendations. In general, the recommendations adequately address the vulnerabilities identified. However, we urge (global) authorities to work more together and rather rely on each other's databases / information than imposing more (burdensome) data requirements on market participants. Furthermore, to grant (local) authorities direction towards fund managers what to do in time of crises could have a disturbing effect on the financial market.

Q3. In your view, are there any practical difficulties or unintended consequences that may be associated with implementing the proposed policy recommendations, either within a jurisdiction or across jurisdictions? If there are any, please identify the recommendation(s) and explain the challenges as well as potential ways to address the challenges and promote implementation within a jurisdiction or across jurisdictions.

We have comments stated below on the proposed policy recommendations. The following general key messages we have as mentioned earlier:

- <u>Increasing the excellent work and initiatives on effective cooperation and coordination between (supra) national authorities / legislators</u>

Especially on data gathering from market participants and monitoring systemic risks across all financial sectors holistically (asset management, banking, insurance). Avoid legislation solely focused on single (one dimensional) measurement developed by a single authoritative/legislative body.

- <u>Apply "in depth"- views on leverage and liquidity measures</u>

Ensure to have knowledge on the purpose and use of leverage from the (pension) fund manager (i.e. return enhancing or risk reducing). Furthermore strive to disseminate this knowledge across authorities and legislators.

- Awareness that too much regulation may cause a rigid and illiquid market

A rigid market kind of market may prove not to be resilient in times of crisis and therefore currently there is a need of constant (rapid) adjustment of regulations in order to avoid systemic crisis.

- Investigate unintended high liquidity requirements for pension funds

Due to new banking regulation (Basel III Net Stable Funding Ratio and Leverage Ratio Framework) and market infrastructure regulation (EMIR, Dodd Frank, etc) combined with low competition levels in the clearing market, high liquidity requirements arise for end users causing probably systemic risks in the future and jeopardizing adequate old age pensions.

Liquidity mismatch between fund investment assets and redemption terms and conditions for fund units

Recommendation 1: Authorities should collect information on the liquidity profile of open-ended funds in their jurisdiction proportionate to the risks they may pose from a financial stability perspective. They should review existing reporting requirements and enhance them as appropriate to ensure that they are adequate, and that required reporting is sufficiently granular and frequent.

In our opinion there is already sufficient and extensive reporting to local (in our case Dutch) regulators on the liquidity profile of the funds. Different types of (stressed) scenarios are used to this end. However, it could be the case that differences in the scope of reporting requirements exist among countries, and for several countries this is most likely less extensive than in Europe/Netherlands. Therefore, we suggest IOSCO to investigate whether significant differences exist in reporting requirements and reduce these differences if deemed appropriate/proportionate.

Recommendation 2: Authorities should review existing investor disclosure requirements and determine the degree to which additional disclosures should be provided by open-ended funds to investors regarding fund liquidity profiles, proportionate to the liquidity risks funds may pose from a financial stability perspective. Authorities should enhance existing investor disclosure requirements as appropriate to ensure that the required disclosures are of sufficient quality and frequency. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.

We believe that more relevant information to the investor is useful to increase transparency and trust in the financial / asset management sector. This recommendation we fully support.

Recommendation 3: In order to reduce the likelihood of material liquidity mismatches arising from an open-ended fund's structure, authorities should have requirements or guidance stating that funds' assets and investment strategies should be consistent with the terms and conditions governing fund unit redemptions both at fund inception and on an ongoing basis (for new and existing funds), taking into account the expected liquidity of the assets and investor behavior during normal and stressed market conditions. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.

We think the AIFMD legislation also highlights several requirements on liquidity matching. Therefore, we suggest it would be effective to (partially) harmonize with these AIFMD requirements. IOSCO/FSB could look into these requirements and work together with ESMA in Europe.

Recommendation 4: Where appropriate, authorities should widen the availability of liquidity risk management tools to open-ended funds, and reduce barriers to the use of those tools, to increase the likelihood that redemptions are met even under stressed market conditions. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.

In our opinion the use of liquidity stress-test and regular (for example annual) evaluation of these test should be promoted. To this end there are several stress testing systems available in the market.

Recommendation 5: Authorities should make liquidity risk management tools available to open-ended funds to reduce first-mover advantage, where it may exist. Such tools may include swing pricing, redemption fees and other anti-dilution methods. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.

Our position is that first mover advantages should be minimal. To this end, fund participants should pay a redemption fee, which must regularly be evaluated based on liquidity and market impact. Furthermore, in extreme situations there should be room to deviate for the fund manager and withhold the possibilities of leaving the fund by participants. However, the possibility to apply this liquidity risk management tool should be known to the fund participants.

Recommendation 6: Authorities should require and/or provide guidance on stress testing at the level of individual open-ended funds to support liquidity risk management to mitigate financial stability risk. The requirements and/or guidance should address the need for stress testing and how it could be done. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.

According to our experience in a sound liquidity stress-test different (market) factors should be used and altered. Guidance on solid stress testing is therefore welcome to fund managers. However, stress-tests should also be (partially) re-useable in the context of AIFMD or other regulation that may have similar information/data requirements. Therefore, we recommend IOSCO to work together with other authorities in the area of stress testing.

Recommendation 7: Authorities should promote (through regulatory requirements or guidance) clear decision-making processes for open-ended funds' use of extraordinary liquidity risk management tools, and the processes should be made transparent to investors and the relevant authorities. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.

There exist a couple of extraordinary liquidity risk management tools, such as in kind transfers of assets to a fund participant. We agree on the position and recommendation that the decision making process for these measures should be transparent to investors and relevant authorities.

Recommendation 8: Authorities should provide guidance and, where appropriate and necessary, provide direction regarding open-ended funds' use of extraordinary liquidity risk management tools. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.

We are not sure if it would be helpful to the financial market if authorities would direct the use of extraordinary liquidity measures. This could heavily influence the working of the financial market. The effectiveness of this recommendation will finally depend on the scope and its expected implications. IOSCO could for example set up an expert working group with different stake-holders and market participants in order to carefully implement this and other recommendations.

Recommendation 9: Where relevant, authorities should give consideration to system-wide stress testing that could potentially capture effects of collective selling by funds and other institutional investors on the resilience of financial markets and the financial system more generally.

Stress testing on collective selling of fund participants is possible. However, we doubt the effectiveness of these stress-tests on investment funds / participants. Investment funds are far less leveraged than banks. It could be that the stress test encompasses the selling of specific assets by institutional investors and funds simultaneously, measuring the effect on other (more leveraged) market participants such as banks. Therefore, we advise a "holistic" approach regarding stress tests (across all financial market participants/sectors), and not only (pension) funds / asset managers.

Q4. In your view, is the scope of the proposed recommendations on open-ended fund liquidity mismatch appropriate? Should any additional types of funds be covered? Should the proposed recommendations be tailored in any way for ETFs?

In our opinion a holistic / top-down view is recommended. Therefore, the recommendations should apply to all open-end funds, including ETFs. Moreover, currently there are ETFs on relatively illiquid assets, such as high yield bonds. Not including these could leave an unintended gap in the scope of the regulation.

Q5. What liquidity risk management tools should be made available to funds? What tools most effectively promote consistency between investors' redemption behaviours and the liquidity profiles of funds? For example, could redemption fees be used for this purpose separate and apart from any impact they may have on first-mover advantage?

Our position is that first mover advantages should be minimal. The use of any liquidity risk management tool should not harm remaining participants. Liquidity Risk Management tools as in kind transfer of assets and a redemption fee are possible.

Regarding the redemption fee, we believe it must be regularly evaluated based on liquidity and market impact. Furthermore, in extreme situations there should be room to deviate for the fund manager in its discretion with a known list of liquidity risk management tools (e.g. withhold the possibility of leaving the fund by participants).

Q6. What characteristics or metrics are most appropriate to determine if an asset is illiquid and should be subject to guidance related to open-ended funds' investment in illiquid assets? Please also explain the rationales.

We have the opinion that an asset or the position in assets are illiquid if it cannot be sold for the most part of it in a pre-specified period of time. What percentage to determine "part"(let's say for example 95%) or the duration of the period (for example 10 working days) is asset specific and should be based on extensive (academic) studies.

Q7. Should all open-ended funds be expected to adhere to the recommendations and employ the same liquidity risk management tools, or should funds be allowed some discretion as to which ones they use? Please specify which measures and tools should be mandatory and which should be discretionary. Please explain the rationales.

We believe that although it is wise to have standards regarding liquidity risk management tools, in some cases its useful for funds to have discretion as to decide what risk management tools are best applicable for the fund. Therefore, we are of the opinion that a certain level of discretion is desirable.

Q8. Should authorities be able to direct the use of exceptional liquidity risk management tools in some circumstances? If so, please describe the types of circumstances when this would be appropriate and for which tools

In our opinion as stated regarding recommendation 8 we are not sure if it would be helpful to the market stability if authorities would direct the use of extraordinary liquidity risk management tools. This could potentially heavily influence the working of the (financial) market.

Leverage within funds

Recommendation 10: IOSCO should develop simple and consistent measure(s) of leverage in funds with due consideration of appropriate netting and hedging assumptions. This would enhance authorities' understanding of risks that leverage in funds may create, facilitate more meaningful monitoring of leverage, and help enable direct comparisons across funds and at a global level. IOSCO should also consider developing more risk based measure(s) to complement the initial measure(s) and enhance the monitoring of leverage across funds at a global level.

In our view, if all funds are measured by the same or very few measures of leverage, this could create systemic vulnerabilities arising from concentration risk as a result of similarity in adjusting of fund managers to these/this measure(s).

For example, if in times of stress the monitoring proves to be insufficient (i.e. due to "window"-dressing), there could be a systemic problem and all funds probably react in a similar way to resolve their leverage/liquidity issues.

A Leverage Ratio Framework that authorities would apply should therefore include multiple, preferably risk based, measures. When developing a measure, IOSCO and other authorities involved, must be very concerned about the indirect risks that arise from market participants adapting to the measure.

Recommendation 11: Authorities should collect data on leverage in funds, monitor the use of leverage by funds not subject to leverage limits or which pose significant leverage related risks to the financial system, and take action when appropriate.

Based on our experience, local authorities, such as the Dutch Central Bank, already collect significant amounts of data on leverage of funds. Oversight on the use of leverage is also something we support. We would like to stress that authorities should work together when examining aggregate data from multiple countries/continents. If many authorities require similar information from market participants is, in our opinion, less effective and operationally burdensome.

Moreover, we are not sure/convinced if it would be helpful to the financial market if authorities would take action when they deem appropriate. This, or the possibility to do so, could heavily influence the working of the financial market.

Recommendation 12: IOSCO should collect national/regional aggregated data on leverage across its member jurisdictions based on the simple and consistent measures(s) it develops.

IOSCO could collect data on leverage across its member jurisdictions based on the simple and consistent measures(s) it develops. However, a lot of data is already provided to different (international) institutions, such as ESMA, and (national) central banks etc. "Sharing" of data and "linking" of databases between (local) authorities that require data should be the first and foremost route to follow instead of IOSCO requiring more data from fund managers on top of other (local) authorities.

Q9. In developing leverage measures (Recommendation 10), are the principles listed above for IOSCO's reference appropriate? Are there additional principles that should be considered?

When developing leverage measures IOSCO should do so from a “holistic”- perspective. This means that it is important to know to what extent borrowed money (leverage) is used and for what purpose by the (institutional) investor / market participant.

For example interest rate derivatives are used by pension funds to stabilize their solvency level. This is a risk reducing purpose and not to enhance returns as one could argue for hedge funds. Furthermore, stress tests could in this respect give insight where possible problems may arise as a result of the use of leverage also in combination with its purposes, but then include all financial market participants (also banks).

Moreover, we highlighted several points to take note of when developing leverage measures at our response to recommendation 10 as well.

Q10. Should simple and consistent measure(s) of leverage in funds be developed before consideration of more risk-based measures, or would it be more appropriate to proceed in a different manner, e.g. should both types of measures be developed simultaneously? This may mean, for example, avoiding overly granular specifications for inputs and the use of estimated parameters and sensitivities based on risk models which may be fragile. For funds that are involved in off-balance sheet transactions (e.g. derivatives), such leverage limits should include synthetic leverage measure(s).

We believe that overly simple measures are not proportionate. Measures to be developed could be conceptually similar to the Basel III leverage Ratio framework and the Basel III Net Stable Funding Ratio. This means a combination of few simple and more complex risk based measures.

When developing these measures, IOSCO and other authorities should actively consult market participants from the entire financial sector. As an illustration, currently in the Basel III proposed banking regulation, High Quality Liquid Assets (HQLA), such as government bond, are not fully recognized. This has a (unintended) burdensome effect for market participants other than banks on their liquidity profile and (trading) costs.

Q11. Are there any particular simple and consistent measures of leverage or risk-based measures that IOSCO should consider?

We believe the answer to this question should be thoroughly worked out in a (multi) market participant and (legislative) authorities working group. Moreover, there is probably lots of work done in this field, for example at the Basel Committee on Banking Supervision regarding the Basel III Leverage Ratio Framework and the Basel III Net Stable Funding Ratio.

Q12. What are the benefits and challenges associated with methodologies for measuring leverage that are currently in place in one or more jurisdictions?

Benefits:

1. Transparency
Due to the fact that leverage is measured and recognized transparency will increase.

2. Standardization
Leverage Reporting and requirements is possible in many ways. With standardization there will be a clearer picture of the leverage level of each entity. Also, comparison between leverage figures becomes more meaningful and easy.

3. Leverage requirements basic part of investment mandates
End users and authorities can use leverage measures more extensively in their mandates to asset / fund managers when monitoring their investments.

Challenges:

1. Adequately recognizing/identifying (High Quality) Liquid Assets:
In current upcoming banking regulation only cash is fully recognized for netting purposes as to reduce the leverage measure. However high quality government bonds should also be treated like this.

2. Applying a holistic view
Not every leverage applied by funds have the same purpose/goal. Some leverage is explicitly used in order to mitigate the (regulatory) risk profile. This is for example the case for pension funds hedging their interest rate risk.

3. Designing not overly simplistic measures, and arbitrary requirement figures.
For example if legislation requires a maximum of 5% leverage, market participants /investors/regulators should all agree on the reasoning and have understanding of this 5%. Risk based measures often are a more suitable and adjustable solution, however more of a challenge.

4. Effective data requirements to end users
High data requirements cause high operational costs, and a high operational burden for end users.

Q13. Do you have any views on how IOSCO's collection of national/regional aggregated data on leverage across its member jurisdictions should be structured (e.g. scope, frequency)?

We hold the opinion that if IOSCO will collect data it could best align with the frequency, time of delivery and structure/format of other (inter)national authorities such as ESMA.

Q14. Do the proposed policy recommendations on liquidity and leverage adequately address any interactions between leverage and liquidity risk? Should the policy recommendations be modified in any way to address these interactions? If so, in what ways should they be modified and why?

In our view the policy recommendations on liquidity and leverage in itself will greatly help to mitigate systemic vulnerabilities arising from leverage and liquidity needs. However, there are some important points to note in order to avoid "pitfalls" regarding the interaction between leverage and liquidity risk:

1. Adequately recognizing High Quality Liquid Assets in liquidity and leverage measures, not only cash.

2. A lack of recognition of the purpose of leverage applied by end users / asset managers. Leverage in the form of the use of derivatives for the purpose of mitigating risks (for example used by pension funds) should be treated differently than for the purpose of enhancing returns (Hedge Funds)

3. Legislation that is tailored at reducing leverage should not heavily impact the current liquidity needs / liquidity profile and possibilities in the market to obtain liquidity for end-users.

Operational risk and challenges in transferring investment mandates or client accounts

Recommendation 13: Authorities should have requirements or guidance for asset managers that are large, complex, and/or provide critical services to have comprehensive and robust risk management frameworks and practices, especially with regards to business continuity plans and transition plans, to enable orderly transfer of their clients' accounts and investment mandates in stressed conditions.

We fully agree with the Financial Stability Board that large, complex, and/or provide critical services to have comprehensive and robust risk management frameworks and practices, especially regarding business continuity plans, transition plans, and OTC derivatives clearing under EMIR. Furthermore, we believe the scope should be extended to all asset managers.

The business continuity plans for asset managers are currently reviewed by (local) authorities. To our opinion the reviews and requirements regarding business continuity plans are sufficient and extensive in Europe.

Regarding 'stressed conditions' and 'transition management' from a pension fund perspective, we use the following definitions. These definitions can help authorities to set global requirements:

<u>Stressed conditions</u>
We regard a financial crisis as a situation with rapidly growing and extreme risk aversion amongst financial market participants. In addition this should coincide with a global 'systemic event'. In other words, this means for a financial crisis to be considered systemic, its implications need to have global reach. Exceptions to this are more regional crises which can endanger critical (coverage) ratios/ (leverage and liquidity) measures of pension funds, as defined in their contingency plans.

<u>Transition management</u>
We regard transition management as managing the transformation of one or more portfolios from its current composition or place to a distinct other composition or place. Therefore, transition management can take place within an asset category (for example between emerging market sovereign bond managers) or across several different type of asset classes (for example emerging market sovereign bonds to European Equities).

<u>Transition management process</u>
In our view, transition management is a very important part of ongoing portfolio management. The transition management process described below could serve as a guideline for all asset managers / fund managers, and in our opinion this guideline should include mandatory global standards that could be set by the Financial Stability Board in cooperation with regional and local authorities.

Panel of transition managers and appointment
The process starts at a so called "panel of transition managers". We believe, every asset manager should have a panel of transition managers in place to select the best and most suitable transition manager for every specific transition (some transition managers are specialized in certain markets / asset categories). However, all transition managers on the panel should be able to carry out transitions for equities and/or fixed income. The panel must consist of at least two transition managers, but preferably more. This will increase the competition element among them, which is aligned with best execution.

To appoint a transition manager on the panel, a selection process is used similar to the appointment of a regular (external) manager for an asset category, such as equity or fixed income. This search encompasses a definition/assignment, long list, short list, onsite (operational) due diligence and choice for one or more managers. The entire selection documentation has to go through a thorough approval process, which needs to be ratified by a (internal) committee. The final contract between asset manager and transition manager needs to be supervised by respective legal affairs department.

Selection transition manager
The start of the selection of the transition manager is to request the panel of transition managers to carry out a “pre-trade”-analysis. The “pre-trade”-analysis should include a costs estimation and transition plan. The asset manager will then choose the transition manager with the best combination of estimated costs and suitable transition plan based on experience.

Transition planning
The transition is, prepared and executed by a working group that consists of professionals from the transition manager, custodian, and asset manager. During the transition there is daily contact between the group members. If needed, conference calls and meeting will be scheduled.

Use of derivatives
Derivatives have a positive influence on transition management. They are used to fill the necessary gaps in desired exposure to certain markets. In this sense derivatives are explicitly used for hedging of risks that impact the outcome and costs of the execution/trading. Moreover, derivatives are mostly used for the management of currency risks and sector / country exposures.

Reporting
The transition manager prepares a post-trade report when the transition is completed. The post-trade report encompasses the transition execution process (strategy, market circumstances) and the cost decomposition (including the greatest contributors).

EMIR (central clearing) – Porting in stressed times
Another important transition of accounts / position happens under the new central clearing setup. The transfer of cleared OTC derivative trades among clearing members at a clearing house is called “porting”. Among market practitioners that currently investigate the clearing setup there is a general agreement that porting during stress conditions (i.e. after a clearing member default) is very problematic and probably impossible

- We recommend to give this “porting” - issue priority when developing requirements to asset managers, clearing houses and clearing members.

Q15. The proposed recommendation to address the residual risks associated with operational risk and challenges in transferring investment mandates or client accounts would apply to asset managers that are large, complex, and/or provide critical services. Should the proposed recommendation apply more broadly (e.g. proportionally to all asset managers), or more narrowly as defined in Recommendation 13? If so, please explain the potential scope of application that you believe is appropriate and its rationales.

We believe the proposed policy recommendation 13 should apply to all asset managers. It is desirable to have an equal level playing field in this respect. Operational risks are increasingly important, and should be safeguarded by effective standardized requirements for all financial market participants in the asset management industry in order to protect end-users.

However, we would like to stress that too much regulation could endanger innovation, or new entrants in the asset management industry.

Securities lending activities of asset managers and funds

Recommendation 14: Authorities should monitor indemnifications provided by agent lenders/asset managers to clients in relation to their securities lending activities. Where these monitoring efforts detect the development of material risks or regulatory arbitrage that may adversely affect financial stability, authorities should verify and confirm asset managers adequately cover potential credit losses from the indemnification provided to their clients.

Q16. In your view, what are the relevant information/data items authorities should monitor for financial stability purposes in relation to indemnifications provided by agent lenders/asset managers to clients in relation to their securities lending activities?

In our opinion information regarding collateral and counterparty risks/ limits are relevant in relation to indemnifications. Examples in this case are information on the diversification of collateral and collateral valuation methodologies. Furthermore we would like to stress that under the European Market Infrastructure Regulation (EMIR) and the Securities Financing Transactions Regulation (SFTR) lots of relevant information already is gathered.

Q17. Should the proposed recommendation be modified in any way to address residual risks related to indemnifications? For example, should it be more specific with respect to actions to be taken by authorities (e.g. identifying specific means for covering potential credit losses) or more general (e.g. leaving to authorities to determine the nature of appropriate action rather than specifying coverage of potential credit losses)?

We encourage the FSB to consider that indemnification related exposure, which is provided by agent/lenders, should be made public through current trade repositories. The benefit of access by market participants is twofold:

1 Improving the due diligence process when a (pension) fund selects an agent / lender.
2 Enhanced monitoring of current selected agents.

Moreover, in a similar setting, there are repositories under SFTR for the collection of securities financing transactions and under EMIR for the collection of OTC derivatives trades (bilateral, cleared and exchange traded). However, at this moment only supranational supervisory authorities like ESMA have access to these repositories.