Secretariat of the Financial Stability Board

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Financial Stability Board

Recovery and Resolution Planning: Making the Key Attributes Requirements Operational

Consultative Document

Dear Sirs,

The Investment Management Association (IMA) welcomes the opportunity to comment on making the key attributes requirements for recovery and resolution planning operational.

The IMA represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes.

They are responsible for the management of £4.2 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles.

Key messages

We support the efforts of the authorities, at all levels, to implement resolution regimes and, with regard to cross-border financial institutions, to align their approaches.

The main focus of the authorities and politicians has been on deposit takers and credit institutions, but it should not be forgotten that these banks serve the firms that manage savings, investments and pensions, much of it money from retail investors. Therefore, the (other) critical functions that are relevant to investment management should be considered by regulators, e.g. payment, settlement, trusteeship/depositaryship (i.e. the legal ownership of the assets as opposed to the beneficial ownership of them), cash management and custody. We welcome the references, especially in the Appendix, to the services provided by banks to capital markets.

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Payment, clearing and settlement services are provided by banks to their clients. Some services may be provided by a non-bank entity of the firm, e.g. broker-dealers. Such services are often on a cross-border basis, e.g. foreign exchange clearing and cash management. As a consequence, recovery and resolution plans should cover services provided by the non-bank and overseas arms.

Basel III changes the economics of finance, making bank lending more expensive, thus enabling other intermediaries, for example investment funds, to step in by way of equity and debt capital markets. As the financial system evolves, the importance of other/non-bank providers of capital and how they fit into the infrastructure should be considered by policy-makers.

However, we feel that it would be disproportionate to apply such a regime to asset managers as we do not consider them to be within the scope of the consultation, i.e. asset managers are not a type of *"financial institution that could be systemically significant or critical if it fails and should be subject to a resolution regime that has the attributes set out in this document ("Key Attributes")".*

We do not believe that there is a justification for extending the regime to asset managers or the funds that they manage. Asset managers are not systemically important, either on an entity or sector basis. They merely act as agents for their clients. Their activities do not extend to the provision of credit, the acceptance of deposits or dealing on their own account. No asset manager failed as a result of the crisis and there was no provision of any government support, unlike for the banks. Any client money that is held is segregated from the assets of the manager and would not be affected in the event of any financial difficulty being encountered by the firm.

As an agency business model, an EU asset manager already maintains a comprehensive wind down plan as part of its current prudential regime. Under this, an assessment of relevant contract terms and other firm commitments is undertaken with a view to ensuring the adequacy of resources, including capital, to effect the orderly termination of contracts with clients and wind down of the entity. We see no justification for including asset managers in proposals aimed at systemically important sectors, as an asset manager's risk of failure is sufficiently mitigated by its current wind down arrangements, which in the United Kingdom is part of the Financial Services Authority's (FSA) Individual Capital Adequacy Assessment Process (ICAAP).

We believe that extending the Recovery and Resolution Framework to such entities and the funds they manage would increase cost, administration and complexity with no evident benefit to the general economic well-being, and would distract asset managers from focussing on more relevant prudential measures.

The list of triggers and stress scenarios is wide ranging and useful guidance, but will vary according to the characteristics of the firm. As such, regulators will have to be vigilant and understand the workings of firms.

Differences in domestic law and supervisory approaches, structural reforms and competing political pressures complicate resolution, including the substitution of providers. As such, the authorities should work together to ease such complications.

Conclusion

The IMA looks forward to working with the international standard setters to develop a framework that is appropriate and effective for all stakeholders.

Annex 1 to our letter contains our formal response to the consultation, and further specific observations and questions arising from the proposals.

Annex 2 summarises the critical functions that are essential for the asset management industry to survive.

We hope that you will find our comments useful. Please contact me by way of e-mail (ihenry@investmentuk.org) or telephone on (00 44) (0) 20 7831 0898 should you require further information.

Yours faithfully,

Irving Henry

Prudential Specialist

Investment Management Association

Annex 1

Guidance on Recovery Triggers and Stress Scenarios (Annex 1)

1. Does Annex 1 appropriately identify key emerging practices regarding recovery triggers and stress scenarios? What additional triggers of an institution-specific or general nature may be useful?

The list of triggers is comprehensive and can be used as guidelines that evolve.

Additional metrics could include the ratio of deposits to loans and, in anticipation of their coming into force later this decade, a sort of leverage limit and net stable funding ratio.

Ratings downgrades should be with regard to both the sovereign and the firms regulated by that sovereign.

Currency crises should not be limited to the Euro and US Dollar.

Reputational damage is linked to liquidity. There may be funding difficulties well before capital depletion.

Reverse stress testing is mandatory for all firms. It's not the case that "some G-SIFIs also perform such testing".

2. Are there certain quantitative recovery triggers that are likely to be more effective than others across different types of financial institutions?

The triggers will vary according to business model, home state etc.

3. What kind of qualitative recovery triggers are likely to be most helpful to decision makers within the banking group?

As above, the triggers will depend on the nature, scale and complexity of the firm.

4. How can financial institutions achieve the goal of early and effective internal triggers, while avoiding negative market reaction to recovery actions taken?

This will depend on their living wills and how they manage expectations.

5. Are there certain triggers that are more suitable as early warning indicators for pre-emptive recovery actions versus trigger events that are more suitable for particular recovery actions?

As above, triggers are somewhat bespoke. There's no one size fits all.

6. Are there any other issues in relation to the implementation of the Key Attributes requirements for recovery planning that it would be helpful for the FSB to clarify in further guidance?

No further comment.

Guidance on Developing Resolution Strategies and Operational Resolution Plans (Annex 2)

7. Does Annex 2 adequately capture the key elements of a resolution strategy and operational resolution plan? If not, what aspects are missing or need to be changed?

The annex does capture the essentials. These will evolve.

8. What are potential obstacles to the effective implementation of either the 'multiple point of entry' (MPE) or 'single point of entry' (SPE) approaches that could arise from national legal frameworks (e.g., insolvency law)? How could they be addressed?

Obstacles could emerge from the complexity of financial institutions and their supervisors, and political pressures that often accompany crisis situations.

Insolvency, resolution regimes (or even the lack thereof) and supervisory approaches (vide structural reforms in the UK, USA and EU, the UK FSA's integrated group policies for capital and liquidity, and the possible EU defined liquidity group in its iteration of Basel III) all of which amount to "land grabs" that may be understandable from a political perspective, but may complicate resolution.

Regulators by way of colleges of supervisors and management should work towards solutions.

9. What are the implications of the MPE and SPE approaches for the way financial institutions are structured, and what are the likely benefits and costs of any consequential changes in structure?

As per the above comment and market pressure for the more efficient use of limited resources, less complex firms and firms that can fund independently of their groups may emerge. However, self-sufficiency will lead to an increase in costs, both funding and operational.

10. Does the Guidance adequately draw out the key commonalities and differences between the MPE and SPE approaches to resolution?

Yes, the guidelines do so.

11. Does the Guidance adequately accommodate the needs and perspectives of host authorities that are not members of the CMGs for G-SIFIs, especially in those jurisdictions where a G-SIFI may be systemic?

The guidelines are comprehensive and flexible. It may be helpful for non-members to have a memorandum of understanding with member peers.

12. Are there any additional issues in relation to the development of resolution strategies and plans that it would be helpful for the FSB to clarify in further guidance?

No comment.

Guidance on Identification of Critical Functions and Critical Shared Services (Annex 3)

13. Is the two-part definition of 'critical' and the distinction between 'critical functions' and 'critical shared services' a useful taxonomy?

> The taxonomy is helpful. It is helpful that the Financial Stability Board (FSB) recognises that the list of critical functions and shared services is not definitive, and needs to take into account national and business model differences.

14. Is the framework for determining 'critical functions' appropriate? If not, what aspects are missing or need to be changed?

> The framework is fine as guidance and comprehensive, especially in terms of planning for a contingency, for firms and their regulators. Each firm, and its impact (including second, third etc order effects where appropriate), connectedness etc, will have to assessed individually by the management and the firm's supervisors.

15. Do the five broad categories of activities outlined in the Appendix - that is, deposit taking, lending, payments, clearing and settlement, wholesale activities and capital market activities - cover all relevant and potentially critical G-SIFI activities? What additional categories of activities should be added?

> In terms of scope for deposit takers, does the activity cover deposits from the financial arms/treasuries of non-financial corporates? This is related to a definition of what is a financial services firm in the European Union's version of Basel III, Capital Requirements Directive IV.
>
> We are pleased that the FSB mentions the availability of depositor protection, and recognises that, in some cases, protection or government guarantees have failed to prevent instability. For cross-border financial institutions, burden-sharing remains an issue that will need to be resolved.

16. Is the framework flexible enough to cover the different types of business undertaken by G-SIFIs?

> The framework covers the range of activities and provides useful guidance to stakeholders on what to consider when planning for resolution.

17. Is the framework flexible enough to take account of the external environment in which failure is occurring, for example, an idiosyncratic event or in the context of more severe distress in the financial system?

> The framework is flexible to cater for the outside, and whether the stress is idiosyncratic or systemic.

18. Is the definition and framework for determining 'critical shared services' appropriate? If not, what aspects are missing or need to be changed?

> The definition and details are appropriate and clear. No change is necessary. In any case, they can be interpreted as guidelines.

19. Are there any other issues in relation to the identification of critical functions and critical shared services that it would be helpful for the FSB to clarify in further guidance?

No further comment.

Annex 2

As per the key messages, the functions that are of importance to the fund management industry are as follows:

1) Payments, clearing and settlement

These services are provided by banks to their clients. Some services may be provided by a non-bank entity of the firm, e.g. broker-dealers. Such services are often on a cross-border basis, e.g. foreign exchange clearing and cash management.

The drivers of criticality are market concentration and the availability of substitutes, geographical footprint, complexity of services and asset classes for clearing, links to ancillary services (transaction accounts (including collateral for transactions), deposits and custody) and the reliance of financial market infrastructure (FMI) providers on banks.

2) Wholesale activities

This refers to lending and borrowing in the wholesale markets between financial counterparties. Stress can lead to funding and liquidity strains if the firms are of systemic importance (e.g. major providers of liquidity and/or funding by short-term deposits (net stable funding ratio)).

The drivers of criticality are systemic importance and interconnectedness, market concentration, maturity transformation and leverage.

3) Capital markets activities

This is about the issuance and trading of securities, often related to advisory services and prime brokerage. Such activities rely on payment, clearing and settlement functions.

The drivers of criticality are market concentration and the availability of substitutes, whether services are bundled, and the portability of client accounts across providers and markets.