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c/o Bank for International Settlements
CH-4002 Basel
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AXA INVESTMENT MANAGERS' response to Financial Stability Board's Consultative Document regarding Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities

Dear members of the Secretariat,

AXA Investment Managers (AXA IM) is glad to respond to Financial Stability Board's Consultative Document regarding Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities.

Introductory Comments

We welcome the approach by the FSB to focus on the activities of asset managers rather than designating individual companies as systemically important.

However:

- the FSB does not seem to take enough into account the existing sets of regulatory measures which have already been developed and tested in practice in various regions, in particular in the EU with the AIFM and UCITS Directives, as well as the own conclusions drawn by IOSCO regarding the appropriate management of risks by asset management companies (e.g. the IOSCO 2015 report on fund liquidity risk management tools, which concluded that these tools allowed for managing situations without generating the occurrence of systemic risk);

- If the FSB wishes to tackle the development of market-based finance:

  - It should take into account that **between two thirds and three quarters of financial assets are directly managed by investors – i.e. without passing through asset managers: the FSB itself refers to McKinsey and PWC studies providing for such data:**
    "(...) according to one source [PWC], *third party asset managers as a group only manage about one-third of the total financial assets* [of institutional investors]" (FSB Consultative Document, p.7)
    "The remaining assets are managed by the investor or asset owner without the help of independent asset managers: McKinsey indicates that the percentage of assets managed by third party asset managers relative to total financial assets (including those managed internally by institutional investors)" represented only 22% in 2011 (FSB Consultative Document, p.7)

  - **But surprisingly the FSB focuses then its attention only to the part passing through asset managers**

  - **Based on the market data provided by the FSB itself and mentioned above, we think that a systemic risk approach of market-based finance should follow a holistic approach *of financial markets*, tackling the systemic impact on financial markets of *all* market participants, based on the actions they take on the markets – whichever these market participants are, e.g.:**
    - a pure individual, e.g. citizen Singh prosecuted by US courts for having generated the US flash crash in 2010
    - a large entity investing on financial markets its revenues coming from oil, some of them having highly contributed to market downturns in 2015 and 2016
    - etc.

    Giving such examples does not necessarily mean that such types of participants should be more regulated than today. It just shows that various types of players may destabilise financial markets whatever their profile is – and therefore it should be **the regulation of the financial markets themselves and/or its enforcement, dealt with from a holistic perspective**, which should be enhanced in order to tackle the systemic risk of market-based finance, rather than regulating in silos the various types of players involved.

  - **As a consequence, we consider that this market-based systemic approach, based on a holistic approach of financial market regulation, should repeal the previous approach based on the so-called NBNI G-SIFIs.** We are deeply concerned by the FSB statement in page 2 that the FSB announces that it will revisit the scope of NBNI G-SIFI assessment methodologies jointly with IOSCO, by keeping an entity-based approach in addition to a market-wide activities-based policy. For us, there is no justification for piling both a holistic approach of market activities covering all market participants, and keeping in addition a siloed approach for NBNI G-SIFIs: the key point are the activities on capital markets, whichever the type of player involved, and more precisely is the market impact of such activities.

  - Regarding data reporting, we positively take note of FSB statement in its Consultative Document (p. 14): *"any additional reporting requirements should be proportionate to the benefits they bring to authorities to assess potential financial stability risks and/or take needed actions for financial stability purposes."* But one step beyond, FSB should also invite market regulators to make a better use of the already currently collected market data – as well as assessing the actual need for such multiple and sometimes even redundant reportings - before launching new regulatory initiatives in this area.

- On the methodologies to manage risks, please note that the European fund directives already require to manage risks with scenarios both in normal market conditions and in stressed market conditions. However, going further than such required principles should be avoided, as a prescriptive description of the parameters to be taken into account would generate a new, systemic risk if all asset managers had to apply a single, detailed method. What is important instead is to make sure that regulators check and validate the various methods applied by asset managers, rather than requiring asset managers to apply a single method which would inevitably lead to systemic risk.

1. Introduction

***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 agree that liquidity and leverage may pose risks, but these risks – at least from a European regulatory perspective – are already appropriately managed through several Directives (e.g. AIFM and UCITS Directives). For instance, the AIFM Directive:
  - Was explicitly initiated to tackle the potential sources of systemic risk involved in non-UCITS and asset management activities;
  - Has already imposed specific provisions, methodologies and reportings on liquidity risk management and leverage management;
  - Has been positively tested in practice through various market shocks since its adoption.

- We are therefore concerned that a global approach, led through this FSB proposal, could lead to new provisions, methodologies and reportings on liquidity risk management and leverage management which would delete the existing provisions prevailing in Europe and which did not lead to any market failure: we have to avoid a leap in the dark and instead rely on existing and positive provisions.

- We don't see additional structural vulnerabilities.

- We have taken note of Annex 2 on pension funds and sovereign wealth funds. This siloed thinking about systemic risk fails to take into account the wider risks across the whole capital markets. We believe the approach should focus on market-wide activities, irrespective of the type of investor involved. This means that analysis and policy recommendations should take into account the full spectrum of market participants, but **by having an exhaustive view of market activities carried out by the whole spectrum of market participants.**

***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 are concerned about the following Recommendations:

- Recommendation 9:

Stress-testing should not replace a market-wide approach, which should take into account the actual activities on markets whatever the profile of the market participant is (e.g. day trading);

- Recommendation 10:

  The notion of "consistent measure(s)" for leverage is very ambiguous, and therefore very dangerous: a one-size fits all measurement of leverage:
  - Might not be appropriate depending on the type of fund profile or strategy. E.g. just in Europe, several methods for measuring the leverage are allowed by European Directives, in order to make sure they best fit the fund profiles or strategies. For instance, both the commitment and VaR methodologies can be applied
  - Might depart from the existing European methodologies, although these European methodologies have been positively tested for several years and through several market shocks.

  We therefore propose to amend the drafting of the Recommendation 10, to read: "consistent measure**S** of leverage in funds". In particular, both the Commitment approach and the VaR approach should be preserved, as they have been tested successfully in Europe for long.

- Recommendation 12:

  Same remark as for Recommendation 10 on "consistent" measure**S**.

On the taking into consideration of stressed market conditions, please note that the European fund directives already require to manage risks with scenarios both in normal market conditions and in stressed market conditions (e.g. AIFM Directive, Article 16 (1), second paragraph). However, going further that such required principles should be avoided, as a prescriptive description of the parameters to be taken into account would generate a new, systemic risk if all asset managers had to apply a single, detailed method. What is important instead is to make sure that regulators check and validate the various methods applied by asset managers, rather than requiring asset managers to apply a single method which would inevitably lead to systemic risk.

***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.*

As already said above, **a prescriptive description of the parameters to be taken into account would generate a new, systemic risk if all asset managers had to apply a single, detailed method**. What is important instead is to make sure that regulators check and validate the various methods applied by asset managers, rather than requiring asset managers to apply a single method which would inevitably lead to systemic risk.

2. Liquidity mismatch between fund investments and redemption terms and conditions for fund units

Lack of information and transparency

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.

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.

Gaps in liquidity management both at the design phase and on an ongoing basis

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 behaviour during normal and stressed market conditions. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.

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.

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.

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.

Adequacy of liquidity risk management tools to deal with exceptional circumstances

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.

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.

Additional market liquidity considerations

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.

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?

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We welcome the helpful text on liquidity mismatch as it contains significant details about "mitigants", as ICMA-AMIC, in cooperation with the European Fund and Asset Management Association (EFAMA), wrote it in a report in April 2016 on fund liquidity risk management in Europe.

We believe that Recommendations 1-3 on information collection and disclosure look broadly compatible with UCITS and AIFMD and market practice in Europe. Furthermore, we strongly welcome Recommendations 4 and 5, about increasing the availability of liquidity risk management tools to open-ended funds. This should not be limited to open-ended funds only.

With regard to Recommendation 6 on stress testing, we believe FSB and IOSCO should avoid the temptation to prescribe in great detail how funds should design stress tests for their funds. If stress tests were the same across the world without taking into account the diversity of funds and underlying end-investors, such tests could provide highly misleading results and potentially become paradoxically a new, additional cause of systemic risk.

The governance process around using liquidity risk management tools in Recommendation 7 is important and is currently robustly regulated in AIFMD and UCITS in Europe.

We welcome guidance about the use of tools in Recommendation 8, particularly the clarification about the "extraordinary" nature of these liquidity risk management tools.

It is very important, with regard to Recommendation 9 on system-wide stress tests, that like in Recommendation 6, FSB and IOSCO are not tempted to over-prescribe stress tests. Moreover, any stress tests should understood as ***market* system-wide** stress tests.

Regarding ETFs, we think that by nature they are more pro-cyclical than actively managed funds, as there is a more identical investment objective among investors of ETFs, as their objective is to look for beta - and not for alpha, contrary to investors investing in actively managed funds. We therefore think that at least the measures proposed for open-ended funds in general should also apply to ETFs.

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?*

In the EFAMA/AMIC report on fund liquidity risk management, we reviewed a significant number of tools, both to reduce first-mover advantage and protecting investors in case of severe stress in markets. We believe that competent authorities should allow as many tools as possible for fund managers, stressing that they are only meant to be used in exceptional circumstances.

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 urge FSB and IOSCO to not think of specific metrics and not prescribe liquidity criteria for open-ended funds' investment in illiquid assets. There are high difficulties in making use of metrics such as trade volumes, quotes, or bid-ask spreads, potentially leading to misleading pictures of liquidity in the market.

However, keeping Recommendation 1 is very important and helpful – as long as it remains a general principle without a specific metric, and as long as regulators validate and monitor the internal methods for assessing the liquidity profile of the funds.

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 it is important that open-ended funds should be allowed discretion in choosing what tools to use. It is important to allow flexibility for fund managers and their supervisors to tailor any extraordinary measures correctly to the situation, as fund failures or risks of failure are rarely similar. As we've stated above, we believe that the broadest possible range of tools should be made available to open-ended funds (and closed-ended funds), but their use should not be mandated in a prescribed way. The potential diversity in actions would ensure avoiding destabilising the markets (as compared to a single action by all fund managers, which might potentially lead to an unintended orientation of the market).

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.

Competent authorities already possess the power to direct the use of exceptional tools. It is important that authorities act in cooperation with both affected funds and the industry as a whole when facing such situations. Equally, fund managers would obviously be expected to coordinate closely with their competent authorities before employing exceptional liquidity risk management tools.

3. 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.

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.

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.

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?

The main recommendation on leverage, i.e. Recommendation 10, contains the somewhat ambiguous wording of developing "simple and consistent measure(s)" of leverage in funds. We are concerned by the use of "consistent", as in Europe AIFs and UCITS funds have different methods of measuring leverage (the commitment method and the VaR method). Investment funds, whether open-ended or closed-ended, represent a very wide diversity of investors and employ a wide diversity of investment strategies. Different measurements of leverage are appropriate to be more meaningful depending on the type of fund.

We would not want this FSB/IOSCO work to lead to a single leverage measurement. We would want to build in enough flexibility for methods of measuring leverage so that the figures reflect leverage accurately. In particular, the

Commitment method and the VaR method, successfully tested in Europe for many years through the UCITS and AIFM Directives, should be kept. FSB should thus confirm the plural of measure**S**.

With regard to Recommendation 11 we can agree that authorities should collect data, as already required through current EU rules in UCITS and AIFMD – as soon as they are equipped to collect them and make use of them.

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 measure be developed simultaneously?*

In order to develop a better picture of the nuanced investment fund use of leverage, it is recommended that:

- the Commitment approach be considered as the basic "simple and consistent measure of leverage",
- being possibly replaced by the VaR method depending on the fund profile,
- as this alternative dual approach has already been positively tested in Europe through the UCITS and the AIFM Directives for many years.

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

Multiple calculation methods should be allowed to co-exist, as some are more appropriate to certain funds than others (even within fund types there can be multiple methods, as the method used may be more suited to different kinds of underlying assets or derivatives used by the funds).

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

The Commitment and VaR approaches have their own merits and have been successfully tested in Europe for long, through the UCITS and AIFM Directives.

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)?*

The experience taken from the UCITS and AIFM Directives by the European national regulators members of IOSCO should be helpfully be taken into account to allow for the aggregation of data at IOSCO level – as soon as we know what the data are going to be used for.

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?*

Existing good practices already require to take into account the leverage in fund risk management, including regarding liquidity risk management.

In addition, in Europe specifically AIFMD requires that stress-testing must take into account market effects, which necessarily involves leverage.

4. **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.

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 noted that the language in Recommendation 13 tries to differentiate "large" managers or "complex" managers from the rest of asset managers. We don't agree: we think that the same set of regulations should apply to the whole world of asset managers (in a way, the potential operational risks within a smaller asset manager might even be bigger because smaller asset managers are less well equipped and have less means to cope with them – e.g. on business continuity plans). In particular, **beyond the mere spectrum of asset managers, a systemic risk may be generated by any type of player and whatever its size – that is why, more generally, for market-based finance we are asking for a market regulation (based on the market impact of actions carried out on the markets, whatever the size of the player is) rather than a player regulation**. Therefore, contrary to Footnote 57, we don't think that the amount of AuM should lead to a differentiated regulatory treatment among asset managers: this is for the whole set of asset managers that Recommendation 13 should apply (including business continuity plans, which are already specifically required through European legislation for asset managers).

In addition, a differentiation must be made between the funds and their managers: even if an asset manager goes to default for any reason, the funds it used to manage remain. In practice today, the management of such funds is done then by a new asset manager designated by the client in the case of mandates, or by the fund administrator in the case of non-dedicated funds.

Moreover, the word "comprehensive" should be replaced with the word "appropriate", as legally speaking it would be very difficult to guarantee a "comprehensive" risk management framework in practice: it is never possible to anticipate all the risks which might occur in the future.

And the word "critical" is very vague and should not be kept.

5. **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?*

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.*

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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)?

Regarding indemnifications in the context of securities lending activities, we think that as indemnifications mean in practice putting financial risks on the balance sheet of the relevant asset management company, some capital should be required to cover such risks. This is very different from the usual activities of asset management companies, through which this is the clients which take the financial risks.

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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 Stéphane Janin, our 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,

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