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BVI's position on the consultative document of the Basel Committee on Banking Supervision: Guidelines: Identification and management of step-in risk

BVI[1] takes the opportunity to present its views on the revised initial proposals for banks on identification and management of step-in risks. We would like to focus on the following issues and new proposals with regard to asset management activities and funds under management:

1. Scope of the new framework and entities under scrutiny

As we understand the new proposed guidelines, the definition of "step-in risk" follows the earlier consultation issued in December 2015: The new framework should apply to banks which provide financial support to an unconsolidated entity that is facing stress, in the absence of, or in excess of, any contractual obligations to do so. This means that asset management companies that are part of a banking group are not included within the framework as long as they are part of the regulatory scope of consolidation of the parent entity.

Compared to the first consultative document, however, certain clarifications have been made to the scope of the new framework. According to **paragraph 25** of the drafted guidelines, in particular, unconsolidated insurance entities and banking regulated entities should not be included in the types of entity considered as long as they are subject to specific prudential treatment. We welcome this approach because it considers that the probability of materialisation of a step-in risk is very low as a result of sector-specific prudential requirements that apply for these entities. We wonder, however, why these exceptions shall be limited to regulated insurance and banking entities. We would like to highlight that equally strict prudential requirements have already been implemented in the asset management sector. This applies in particular to regulated collective investment undertakings such as UCITS or specific types of alternative investment funds (AIF) managed by asset managers and supervised by securities supervisors. The legal prudential requirements for these collective investment undertakings are also intended to avoid or mitigate any step-in risks. Such entities should be out of scope. This approach would lead to a level playing field for all unconsolidated entities which are subject to specific prudential treatment. We therefore request the BCBS complementing paragraph 25 of the drafted guidelines as follows:

> "25. Insurance entities that are currently specifically excluded from the regulatory scope of consolidation while attracting a specific prudential treatment are presumed not to be included within the types of entity considered here. As they are already subject to specific prudential treatment, the same applies to banking regulated entities supervised by banking supervisors **<u>or regulated collective investment undertakings supervised by securities supervisors</u>**."

In the same manner, **paragraph 23** of the drafted guidelines should be clarified in such a way that the drafted list of entities as described in Annex 2 only involves such investment funds which are not regulated and not supervised by securities supervisors.

[1] BVI represents the interests of the German investment fund and asset management industry. Its 99 members manage assets of EUR 2.9 trillion in UCITS, AIFs and discretionary mandates. As such, BVI is committed to promoting a level playing field for all investors. BVI members manage, directly or indirectly, the investments for 50 million private clients in over 21 million households. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

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2. Identification of step-in risk

Independently of the above general remarks, the new approach to give examples and counterexamples to describe the indicators banks should use in identifying entities bearing step-in risk for the bank could be helpful for a better practical understanding and implementation. However, we propose to consider the following issues:

- **Paragraph 48 (liquidity stress/first mover incentive):** We request the BCBS to amend the last sentence of the counterexamples as follows:

  "Separately managed/segregated funds (ie funds that ~~**legally**~~ **actually** have only a single customer**/investor**)."

  According to European fund legislation, it is not permitted to legally or contractually limit a fund to one single investor only. An investment fund must be legally designed in such a way that more than one investor may invest. Indeed, this does not exclude the possibility that in practice only one investor is invested. In the context of Paragraph 48, the factual number of investors should be relevant rather than the legal one.

- **Paragraph 56 (investor risk alignment):** According to the explanation under paragraph 55 of the proposed guidelines, the indicator of investor risk alignment refers to entities whose activities do not sufficiently match the risk profiles of their clients/investors with those of the risk exposures of the entity. The bank should be required to analyse whether the entity's risk exposures are aligned with investors' risk appetites to establish whether the risk exists. The first sentence of the example under paragraph 55, however, is too far reaching in this context and could be misunderstood in such a way that all funds that mix different term and/or wealth expectations into a single fund type are not designed to match the risk profiles of their clients or investors. In Europe, moreover, this example will lose any meaning because all banks are legally required to ensure that such investment funds are appropriate for and correspond to the needs of the investors to whom they are sold. We therefore request the BCBS to delete the first sentence of the example.

- **Paragraph 61 (branding):** We strongly disagree with the general assumption that a "branded house" strategy of a bank which is attached to the entity could lead to a step-in risk. Branded house strategies are general reputational risks which should be out of scope and should be analysed on a case by case basis. It also contradicts the given definition of step-in risk that is focussed on a financial support by a bank to an entity that is facing stress. Where a risk occurs on the level of an entity that is branded by the house strategy, the reputational risk would also infect the bank itself (or even the whole group) because of the branding in the group context. The monitoring process of such potential reputational risks in a group context has to differentiate strictly from the assessment of any step-in risk. We therefore request the BCBS to delete the last sentence of the given example under paragraph 61 of the drafted guidelines.

- **Paragraph 63 (historical dependence):** We expressly request the BCBS to clarify that money market mutual funds (hereinafter: MMF) are not general in scope because step-in of banks occurred in individual cases during the financial crises. We would like to highlight again that the European Commission proposed a Money Market Fund Regulation (MMFR) that will enter into force soon. The MMFR will expressly foresee a ban on any form of sponsor support to prevent such incidents from occurring again. We, therefore, propose to clarify the given example under paragraph 63 that entities with a historical dependence should only be relevant if the prudential framework is unchanged.