Frankfurt am Main,
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BVI's position on the Consultative document on Developments in credit risk management across sectors: current practices and recommendations

BVI[1] gladly takes the opportunity to present its views on the consultative document on developments in credit risk management across sectors.

Our members are asset managers providing management services to collective investment undertakings such as UCITS or AIF. They are subject to a legal and supervisory system under the European UCITS Directive 2009/65/EC or the AIFM Directive 2011/61/EU which requires a strict risk management system. We welcome the assessment made by the BIS that significant improvement in the asset management area with regard to risk management (UCITS/AIFs) has been observed compared to the regulatory environment of the Joint Forum Report of May 2006.

We would like to make the following remarks related to the recommendations 1 and 3:

Recommendation 1: *Supervisors should be cautious against over-reliance on internal models for credit risk management and regulatory capital. Where appropriate, simple measures could be evaluated in conjunction with sophisticated modelling to provide a more complete picture.*

We encourage the Joint Forum to clarify that warning against over-reliance on internal models for credit risk management and regulatory capital depends on the respective business model. Banks, insurance undertakings and investment management companies have completely different business models which have an impact of the credit risk management. Management companies do not need capital requirements in order to back credit risks as all fund's assets are separated from the balance sheet of the investment management company.

The risk profile of highly regulated and transparent investment funds differs significantly from that of other financial products. The individual assessment of the creditworthiness of financial instruments or entities is part of an overall risk-management process by the investment management companies.

Credit risks only arise in the area of asset management as part of the market risks which means the risk of loss for the investment fund resulting from, in particular, an issuer's credit worthiness. This process involves, in the light of the principle of proportionality, the assessment of any risk of each relevant assets invested by the investment funds (including the creditworthiness) and the establishment of an internal risk limit system for any relevant risk (including credit risk) on asset and fund level. The basis of the investment decision process is the risk limit system specified by the independent risk management function in accordance with the overall risk assessment.The portfolio management may only make investment decisions within limits specified by the risk management function or within internal and legal investment limits (such as defined by fund rules). Therefore, supervisory measures against over-reliance on internal models for credit risk management do not necessarily depend on whether capital requirements to back credit risk exist.

[1] BVI represents the interests of the German investment fund and asset management industry. Its 87 members manage assets in excess of EUR 2.4 trillion in UCITS, AIFs and assets outside investment funds. As such, BVI is committed to promoting a level playing field for all investors. BVI members manage, directly or indirectly, the assets of 50 million private clients 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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Recommendation 3*: Supervisors should be aware of the growing need for high-quality liquid collateral to meet margin requirements for OTC derivatives sectors, and if any issues arise in this regard they should respond appropriately. The Parent Committees (BCBS, IAIS and IOSCO) should consider taking appropriate steps to monitor and evaluate the availability of such collateral in their future work while also considering the objective of reducing systemic risk and promoting central clearing through collateralisation of counterparty credit risk exposures that stems from non-centrally cleared OTC derivatives.*

We support the recommendation. In this context, we would like to take the opportunity to point out that European funds (UCITS) have substantial difficulties to provide cash collateral in cases of centrally and bilaterally cleared (OTC) derivative transactions under applicable derivative regulation (EMIR). The ESMA Guidelines on ETFs and other UCITS issues (ESMA/2014/937/EN)[2] expressively restrict the re-use of cash obtained from UCITS repo transactions for such purpose. According to the ESMA guidelines, the acceptable collateral must be highly liquid, valued on at least a daily basis, of high credit quality and sufficiently diversified. Cash collateral may only be reinvested in high-quality government bonds or short-term Money Market Funds (cf. Para. 43 letter (i) and (j)).

We fear that Para. 43 letter (j) of the ESMA Guidelines hampers UCITS`ability to access CCP clearing. The mentioned guidelines, for example, prohibit posting of cash received in a repo transaction as collateral to a CCP, respectively the clearing member.

Highly regulated investment funds (UCIST/AIFs) usually only hold limited liquidity due to the applicable investment rules requiring the investment in eligible portfolio assets or cash used to satisfy redemption requested by investors.

Furthermore, according to German law, securities lending to one counterparty is limited on a gross basis to 10% of the fund’s NAV. Transactions with several counterparties belonging to the same corporate group are all counted towards the same limit. According to the ESMA Guidelines applicable to all UCITS, the combined counterparty risk exposure in relation to OTC derivative transactions, securities lending and repos must not exceed 10% in case the counterparty is a credit institution and 5% in other cases. In Germany, UCITS and other regulated investment funds (AIFs) are obliged to report immediately any under-collateralization of securities loan transactions to the National Competent Authority (BaFin).

Hence, the risk of interconnectedness of UCITS with other market participants potentially leading to a contagion in times of crisis is heavily reduced. The new ESMA Guidelines also require UCITS to put in place a clear haircut policy taking into account the characteristics of each class of assets especially in terms of credit standing or price volatility.

We encourage the BIS to take into consideration in the final document that highly regulated investment funds (UCITS/AIFs) face significant difficulties to generate cash obtained from repo transactions for the purpose to provide cash collateral in cases of centrally and bilaterally cleared (OTC) derivative transactions under EMIR.

[2] http://www.esma.europa.eu/system/files/esma-2014-0011-01-00_en_0.pdf