Comment by

Union Asset Management Holding AG

on the

Strengthening Oversight and Regulation of Shadow Banking

Regulatory framework for haircuts on non-centrally cleared securities financing transactions

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Volksbanken Raiffeisenbanken
cooperative financial network

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Dear Sirs and Madams,

Union Investment welcomes the opportunity to comment on the “Regulatory framework for haircuts on non-centrally cleared securities financing transactions” of the Financial Stability Board (FSB).

We are one of the leading asset manager in Germany and the asset manager of the German Cooperative Banking Network holding more than EUR 230 billion assets under management for more than 4.1 million retail and institutional clients.

Please find our specific comments to the questions below.

Yours sincerely

Schindler

Dr. Zubrod

I. Non-bank financing models that do not pose financial stability risks

G20 Leaders were generally right requesting the mitigation of potential systemic risks associated with “shadow banking”. We appreciate FSB’s clarification that using the term “shadow banking” shall not intend to cast a pejorative tone of that system of credit intermediation, as the word “shadow” otherwise could be associated with a “unlawful activity, hidden in the darkness”.

Even if raised earlier, we would like to stress that regulated investment funds (such as UCITS) are far away from any “dark corners” and that their securities financing transaction activities are even subject to a tighter regulation than the regulation banks have to comply with. For that reason, we also fully support FSB’s aim not to inhibit sustainable non-bank financing models that do not pose financial stability risks (cf. page ii of FSB’s paper issued on October 14, 2014).

However, taking into account that one cannot demand from FSB to know and consider all national- or industrial specifics, we are concerned that without further clarification by FSB on “non-bank financing models that do not pose financial stability risks” in its final report, especially regulated investment funds (such as UCITS) might become subject to an even tighter regulation (without posing financial stability risks), crowding them out of the market for securities financing transactions.

According to Art. 52 para. 1 of Directive (EU) 2009/65/EC, the risk exposure to a counterparty of UCITS in OTC derivative transactions shall not exceed either 10% of its assets when the counterparty is a credit institution or 5% of its assets in all other cases. In extension of ESMA’s power to issue guidelines, which ESMA has been granted with under Art. 16 of Regulation (EU) No 1095/2010, in order to establish consistent, efficient and effective supervisory practice within the ESFS and to ensure the common, uniform and consistent application of *existing* Union law, ESMA issued Guidelines on ETFs and other UCITS issues on December 18, 2012 (ESMA/2012/832EN). According to para. 41 of these guidelines, the risk exposures to a counterparty arising from OTC financial derivative transactions and efficient portfolio management techniques should be combined when calculating the counterparty risk limits of Article 52 of Directive (EU) 2009/65/EC. National competent authorities have implemented this *new* “Union law” into national regulations with a legally binding character.

In other words: The counterparty risk to be borne by the investors of an UCITS, including those related to securities financing transactions being in the focus of FSB, will never exceed a total of 10% of the UCITS assets. In some countries (including Germany) the above also applies to non-UCITS.

Without getting lost in details of further applicable rules and regulations – like a mandatory right to terminate securities financing transactions at any time, concentration limits, mandatory collateralization or the UCITS’ limitation only to act as security lender but not borrower – already the above demonstrates that securities financing transaction activities of UCITS and other regulated investment funds respectively their managers cannot not pose any financial stability risks.

In order to especially maintain UCITS' ability to gain additional income from lending securities, FSB should explain, how "non-bank financing models that do not pose financial stability risks" look like and whether UCITS and other regulated investment funds should be exempted from the scope of additional regulation following FSBs report.

II. Questions

Q1. Do you agree that the application of the framework of numerical haircut floors as described in Section 3.3 to non-bank-to-non-bank transactions will help to reduce the risk of regulatory arbitrage and would maintain a level playing field?

Generally yes. However, we do not believe that most security loan transactions are collateralized with cash.

Q2. In your view, how significant is the current level of non-bank-to-non-bank transactions? Do you expect that level to increase going forward and why? What types of non-bank entities are, or could be, involved in such transactions?

For the reasons provided under Section I. of this response, securities financing transaction having UCITS and other regulated investment funds as counterparty should be deemed non-bank financing models that do not pose financial stability risks (cf. page ii of FSB's paper issued on October 14, 2014) and therefore being out of the scope of the framework of numerical haircut floors.

However, from the perspective of an asset management company we have been made the experience that "non-bank-to-non-bank transactions" are not concluded and believe that also in future securities financing transactions will be concluded with banks. Such especially counts for security loan transactions.

Repos are not used by UCITS and other regulated investment funds anymore, even when they are required especially for being able to provide cash collateral for cleared and uncleared OTC-derivatives. However, according to para. 42 of ESMA's Guidelines on ETFs and other UCITS issues (ESMA/2012/832EN), the purchase price gained under a repo especially is not allowed to be used for providing cash collateral. National competent authorities have implemented this prohibition in a way especially being binding for UCITS. For that reason repos are not used by UCITS and (depending on the jurisdiction) other regulated investment funds anymore. From the perspective of UCITS there is no significance of repos left, neither for non-bank-to-non-bank nor non-bank-to-bank constellations. However, if the regulator will release UCITS and other regulated investment funds from the described prohibition in future, we expect that repos will only take place in the constellation non-bank-to-bank.

Q3. Do the approaches set out above cover all potential approaches in applying numerical haircut floors to non-bank-to-non-bank transactions? Are there any other approaches? If so, please describe.

FSB should especially consider in its approaches the expressive exemption from any numerical haircut floor requirements with respect to entities that are subject to existing regulation already mitigating any potential systemic risks sufficiently (e.g. UCITS).

We are concerned that without further clarification by FSB on “non-bank financing models that do not pose financial stability risks” in its final report, especially regulated investment funds (such as UCITS) might become subject to an even tighter regulation (without posing financial stability risks), crowding them out of the market for securities financing transactions.

Further reference is made to our comment provided in section I of our response.

Q4. Please provide any comments you have on the strengths and weaknesses of the approaches set out above, as well as any other approaches you believe the FSB should consider. What issues do you see affecting the effective implementation of numerical haircut floors for non-bank-to-non-bank transactions?

Please see our response to Q3.

Q5. What forms of avoidance of the numerical haircut floors are most likely be employed for non-bank-to-non-bank transactions? Which of the proposed implementation approaches is likely to be most effective in preventing such avoidance?

As our asset management companies do not undertake non-bank-to-non-bank transactions, we cannot respond to this question.

Q6. If different entity-type regulations are used, do you see the need to ensure comparative incentives across different entity types? If so, please describe any potential mechanisms that may help ensure comparative incentives across entity types?

Different entities are subject to different regulation. The applicable degree of regulation should be considered by auditing whether or not the relevant entity is already subject to a regulation mitigating potential systemic risks sufficiently. For that reason, we also fully support FSB’s aim not to inhibit sustainable non-bank financing models that do not pose financial stability risks (cf. page ii of FSB's paper issued on October 14, 2014).

However, overall we believe that FSB should consider whether it makes sense making banks and non-banks subject to the same haircut requirements in order to create equal basic conditions for all market participants.

Q7. If market regulation is used, should the FSB consider setting a materiality threshold of activity below which entities do not need to register? If so, what could be an appropriate level for such a threshold?

No. The regulation of UCITS demonstrates that there are more ways to mitigate systemic risks. A threshold would not reflect to which extent the transactions are subject to other regulatory instruments ensuring that the default of a market participant will not have contagion effects.

Q8. Do you see the need for a phase-in period in applying numerical haircut floors to nonbank-to-non-bank transactions, and if so how long should it be and why? Does the appropriate phase-in period vary depending on which approach is followed? Should it vary by jurisdiction based on the size and importance of the non-bank-to-non bank sector or should it be consistent across jurisdictions?

Yes. If the consideration of numerical haircut floors becomes mandatory, market participants should especially have sufficient time to negotiate the relevant agreements with their counterparties. The implementation of EMIR has shown that it can take a long time to get agreements in place.

In Germany asset management companies, respectively regulated investment funds are already subject to two parallel existing regulations of which each is leading to an overcollateralization of security loan transactions. On one hand side, the value of the securities lent to a borrower is deemed higher as their real value for collateralization purposes. On the other hands side, haircuts need to be applied as far as collateral received shall be considered by the asset management company as risk mitigating when calculating existing counterparty risks and the utilization of the 10% counterparty risk limit. This overlapping regulation already leads to the circumstance that it is not possible to apply haircuts on instruments which are volatile, because the application of haircuts in addition to deeming the secured obligation higher creates an excessive collateral demand making the regulated investment fund respectively its asset management company unattractive as counterparty. Currently asset management companies are bearing this challenge and are finding out that it is difficult getting in place an agreement on haircuts (on top of the mandatory approach to deem the secured obligation higher that it is) with all counterparties. Considering this current experience, we believe that a phase-in makes sense and should not be shorter than 24 months.

The phase-in should be consistent across all jurisdictions, because the challenge for market participants is same in all jurisdictions.

We would like to stress once more that we believe that it makes sense to regulate sectors, which are not or not sufficiently regulated yet in order to mitigate any potential systemic risks. However, the existing regulation applying on UCITS and other regulated investment funds, which we have described in our response, already considers numerous regulatory elements excluding potential systemic risk associated with securities financing transaction activities of UCITS and other regulated investment funds. As it is FSB's aim not to inhibit sustainable non-bank financing models that do not pose financial stability risks (cf. page ii of FSB's paper issued on October 14, 2014), we kindly ask the FSB to clarify that UCITS and other regulated investment funds are an example of a non-bank financing model that does not pose financial stability risks.