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FRENCH BANKING FEDERATION RESPONSE TO BCBS CONSULTATION ON IDENTIFICATION AND MEASUREMENT OF STEP-IN RISK

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

Key comments on the proposed framework

The FBF welcomes the opportunity to respond to the Basel Committee's consultation on identification and measurement of step-in risk. Generally speaking the FBF is particularly concerned about the Committee's proposal, its scope, and its potential implications, and does not share the Committee's conclusion that step-in risk still brings up the need for a prudential approach. We think that since the crisis the potential situation where banks might step-in to support unconsolidated entities has been extensively discouraged already compared to pre-crisis status. In particular accounting standards are now more risk sensitive and new developments in banks regulation have drawn on the lessons of the crisis. As a consequence there is no need in our view to capture in the prudential scope entities which are not consolidated accounting-wise. The consistency of accounting and prudential scopes is an essential component of the regulatory architecture. In rare cases where banks would be proven to provide support to entities beyond the consolidation scope, it might make sense for supervisors to apply a bank specific surcharge in the context of Pillar 2.

The FBF would like to remind that within many speeches, the BCBS states that increasing overall capital requirements in the context of the post crisis agenda is not an objective of the Committee; rather, capital requirements should be commensurate with underlying risk. We consider that the proposed framework would apply a non-commensurate charge to all banks irrespective of actual behaviors. It is also worth noting that this framework may negatively interact with other BCBS's initiatives such as the recent proposal to revitalize the securitization market.

Moreover, we believe that this proposal may create a moral hazard by letting investors expect that banks would step in may an entity be in financial distress: forcing a bank to hold capital against step-in may have the perverse effect to actually generate a risk that would not have otherwise pre-existed. On the contrary, this proposal may have a pro-cyclical effect in case of financial downturn by discouraging banks to provide support in very specific situations by fear of a general contagion to all unconsolidated entities. In most situations, banks would be reluctant to step-in by fear of a contagion effect.

Last, actually under French company Law when a company is a limited-liability one, its shareholders may not be liable for more than the amount they have subscribed for. One of the sole situations where a shareholder of a limited-liability company may be liable above its equity stake is when it is a “reference shareholder” of an affiliate which is a credit institution. Even though, the intervention of the reference shareholders is far from being automatic. Therefore, by implying that credit institutions could intervene in order to bail-out entities and funds which are not there affiliates but are only managed by assets managers which are part of their group, by all accounts, the step-in scheme would not be compliant with the French company Law and, very likely, the other UE members States’ company law.
Such bail-out would very likely be detrimental to the shareholders and the creditors of our credit institutions due to the fact that the funds used for the bail-out of these entities would be diverted from their natural aim as they would not contribute to the payment of dividends or to the repayment of creditors. Corporate officers of our credit institutions could be considered as liable for having done such choice which may be considered as contrary to their company interest (*intérêt social*).

The step-in scheme, if implemented, would be sending out an extremely negative message (i) to investors who would take into consideration the potential bail-out done by our credit institutions to assess their global risk while they should have only relied on the sole intrinsic characteristics and risks of the entity they are investing in and (ii) to asset managers who could consider that the bail-out would mitigate their own liability and limit the recourses against them done by investors in case of loss and default of the entities they are managing. We consider, the step-in scheme could potentially de-empowered both investors and asset managers while, particularly since the crisis, the aim of the regulators has been the contrary.

Banks could be tempted to intervene more in the strategy of their affiliates acting as asset managers [and in the management of the entities themselves] due to the potential extremely negative impact their defaults could have while, for years, the aim of regulators has been to create totally autonomous asset managers acting independently from their parent companies.

1. Any Step-in risk framework should not be considered within pillar 1

Pillar 2 is bank-specific and based on the bank's own assessment of its risks. In the European Union, competent authorities review ICAAP and ILAAP as part of the supervisory review and evaluation process (SREP)[1]. Thus, competent authorities should already have assessed the significance of the institution's reputational risk exposure and how it is connected with the other risks (i.e. credit, market, operational and liquidity risks) by leveraging the other risk assessments to identify any possible secondary effects in either direction (from reputation to other risks and vice versa).

The possible impact of reputational risk is to be considered when assessing ICAAP and ILAAP frameworks. As step-in risk is closely linked to the reputational risk, it should therefore fall within pillar II and not pillar I. A double capitalization for the same risk should be absolutely avoided. Consequently, the FBF recognize the prudential interest in monitoring bank interaction with the called shadow banking sector but does not understand why the Basel Committee needs to set out a formal approach for capitalization of step-in risk on a broad scale basis. It should be more appropriate to amend existing pillar II regulation.

Finally, we believe that this proposal may create a moral hazard by letting investors expect that banks would step in may an entity be in financial distress: obliging a bank to hold capital against step-in may have the perverse effect to actually generate a risk that would not have otherwise pre-existed. On the contrary, this proposal may have a pro-cyclical effect in case of financial downturn by discouraging banks to provide support in very specific situations by fear of a general contagion to all unconsolidated entities. In most situations, banks would be reluctant to step in by fear of a contagion effect.

2. IFRS and US GAAP are globally consistent regarding consolidation

We note that BCBS refers to IFRS 12 only and not to US GAAP which distorts the message in any manner adverse to European accounting rules. Indeed this implies that IFRS 10, which is the standard for consolidation in Europe, is not conservative enough and that it is necessary to look for other elements in the IFRS 12 reporting.
We remind you that since the crisis and following G20 recommendations accounting standards have changed in Europe as well as in the USA which led banks to re-consolidate many assets. The current IFRS 10 standard on consolidation has become effective on the 1st of January 2014.
Under IFRS 10 consolidation in financial statements is required when an entity is exposed to variables returns from another entity and has the ability to affect those returns through its power

[1] Performed in accordance with Article 97 of Directive 2013/36/EU ("CRD") and in accordance with the EBA Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP Guidelines EBA/GL/2014/13 issued on December 2014).

over the other entity. More formally IFRS set out three elements of control: power (over the investee), exposure to variable returns from involvement with the investee and the ability to use power over the investee to affect the amount of the investor's returns. This leads us to make two remarks: firstly the IFRS approach is fully consistent with the BCBS approach which considers control and influence to be critical factor in whether or not step-in risk exists; secondly the IFRS assessment of the degree of control has to do with risk control and we note that it requires taking reputation risk into account. Therefore we do not understand what justifies a change in the filter.

Moreover US accounting principles (US GAAP) and IFRS principles regarding consolidation being globally consistent it is possible to map them[2].

3. Unintended consequences of questioning the prudential perimeter

Regarding the scope of the new regulation, according to the consultation paper the step-in risk is deemed to apply to entities which are mortgage or finance companies, funding vehicles, securitization vehicles, money market funds (MMFs) and other investment funds, asset management companies (AMC) and commercial entities that provide critical services exclusively to the bank, but the definition excludes insurers and other types of commercial entities.

- **Uneven playing field issue:**
  This mix of different types of institutions and of actors, and the different regulations applying to them is an issue in order to compete with a fair level playing field. For example, if an asset management company is an affiliate of a banking group, including money market funds within its regulatory consolidation, it will be subject to prudential requirements (through the leverage ratio, the capital charge requirements, etc.) contrary to a fully independent asset manager. The step-in approach would thus be far more penalizing for an asset management company being an affiliate of a banking group than for an independent asset manager for which it should have no impact, which constitutes a level playing field issue.
- **Operational implementation issue:**
  Currently accounting and prudential perimeters do not fully overlap. Indeed prudential perimeter is limited to financial institutions. Therefore it would be inconsistent that regulation increases the differences between these two perimeters with the consequence of having the production of prudential figures differing from the accounting chain. We would lose the quality of information produced by the accounting chains.

[2] On relationship with other parties: ASC 810-10-25-38A maps with IFRS 10 §B75;
On control: ASC 810-10-25-38A (a) and (b) map with IFRS 10 §7;
On implicit support: ASC 810-10-25-38F maps with IFRS 10 B54;
On relative levels of control and benefits: ASC 810-10-25-38G maps with IFRS 10 from B68 to B72;
On continuous assessment: ASC 810-10-35-4 maps with IFRS 10 from B80 to B85;
Examples on the consolidation of SIVs and other securitized products: ASC 810-10-55-122 through ASC 810-10-55-133 map with IFRS 10 B Example 15 and Example 16.

- **Potential impact on the leverage ratio:**
  An extension of the regulatory consolidation will impact banks' leverage ratio if many entities were identified as step-in risk embedded entities. The application of both primary and secondary indicators to asset management activities and funds under management will be critical in assessing the impact on own funds requirement and on the leverage ratio.

4. Taking individual and collective rebuttals into account

We believe that the proposal starts with a presumption that step-in pre-exists in the form of implicit guarantees, except if there is a legal collective rebuttal. However, individual case by case rebuttals should also be carefully taken into account. There are many situations where the contract / the bilateral documentation will prohibit any step in. This should be more thoroughly take in into account in the proposal.

For instance, in France the French Banking Law[3] aims at avoiding that risky activities can compromise the financial balance of credit institutions and therefore depositors will be protected. It obliges institutions which have trading activities on financial instruments that exceed defined thresholds[4] to create a dedicated subsidiary for capital market activities and it defines in particular the transactions which are not considered as customer services nor market-making and may be accommodated in subsidiaries.

Moreover the French Banking Law prohibits banks to invest in or to finance highly leveraged funds (i.e. funds for which the exposure overtakes three times their net assets). It voluntarily pushes aside from its scope most of the regulated vehicles: the UCITS, the AIFs with a general vocation intended for the non-professionals, the investment capital funds and the regulated funds for employee savings. Following the example of Volcker Rule, the French Banking Law shows that legislators considered, while preparing a framework which aimed at reducing strongly systemic risks, that the existing regulatory framework for regulated funds (UCITS, AIFM, 1940 Investment Act) was sufficient and that it was not necessary to integrate these funds into the scope of the limitations concerning the relationships between banks and investment funds.

In conclusion, the French Banking Federation urges the BCBS to revisit with the FSB its mandate to regulate the step-in risk. We are confident that the FSB will concur that this earlier request does not correspond anymore to the current accounting, regulatory and legal framework, at least in Europe, and therefore that such regulation of step-in risk would be counterproductive, at a time where so many other initiatives still need to be finalized, in order to resolve the current regulatory uncertainty which is an important hangover on the economic recovery.

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[3] See Loi n° 2013-672 du 26 juillet 2013 de séparation et de régulation des activités bancaires.
[4] See the decree 2014-785 of July 8th, 2014 and the order of September 9th, 2014.

APPENDIX

I. Specific comments concerning certain activities

1. Financing structures

Banks set up financing structures (and become de facto sponsor) in order to secure the collateral (identification and segregation). Banks are not involved in the lives of these structures (the structures are in place for the sole purpose of acquiring assets, such as planes, with a repayment by the rent). The only management option is either that the lessor stops exploiting the assets or decides to exercise his option to buy them (leasing stops).

Therefore banks cannot be considered as having a power of decision ("decision - making" to the BCBS … which does not define the term). Hence they do not control the structure and these structures can therefore not be consolidated according to IFRS 10.

- Pretending to consolidate these structures (which correspond to cases 4 and 5 of the BCBS consultation document: sponsor without decision-making power) is questioning the accounting rules. It will weaken the link between supervision and accounting data (audit trail, accounts certification...), lowering quality of data supervisors rely on;
- The sponsor bank does not necessarily fund the structure fully; most of the time other banks intervene also and the sponsor funding is only partial. In such cases consolidation of the structure within the sponsor balance sheet would generate double-counting, the other banks charging capital on their own exposures to the structure;
- In the case where the lessee defaults, the sponsor bank will intervene not to support the structure but rather to liquidate it and realize the collateral. Reputational risk has nothing to do with that;
- Systematic consolidation of funding structures would change sponsor banks risk profile by replacing credit risk exposures by market risk ones (banks would be exposed to changes in the value of the financed assets).

2. Asset management vehicles

In order not to overestimate step-in risk regarding Asset Management, it seems important to remind some key features of this activity, particularly in France:

- Asset managers Companies (AMC) act as agents for clients that pay them to run their money according to the risk/return profile they agree upon. An AMC has a limited balance sheet and a capital that covers the limited operational risk linked to the agency activity it conducts. A prudential regulation that would introduce minimum capital requirements is not adequate, except for those activities that are usually made by banks.

- Asset management is very highly regulated at the level of the management company, of the fund, of specific activities and the distribution and client relationship. It is closely supervised as well at the European level as by National Competent Authorities. In the European Union we can mention legislations specific to this industry like UCITS[5], AIFMD[6]… or impacting its activities like MIFID/MIFIR, EMIR, SFTR… or impacting its clients like CRD, CRR and Solvency 2… We commend the BCBS those regulations should be clearly and more specifically mentioned in the 1.2 Part (*"Subsequent accounting and other developments since the financial crisis"*).
- Most AMC are not affiliates of banking group and are thus not prudentially regulated as they are not subsidiaries of banking groups; as a consequence asset management activities have been assimilated to market finance and shadow banking. However, in France, the main AMC carry activities that require a banking license and/or belong to banking groups, and are therefore prudentially regulated.

3. Securitization activities in Europe and more especially ABCP conduits

The vast majority of European ABCP Conduits are fully covered by sponsor banks' liquidity lines, generally in the form of full support (both liquidity and underlying credit risk are covered). These banks therefore already include in their capital, leverage and liquidity calculations exposures equivalent to 100% of the conduits' assets. No additional step-in risk exists, which would require prudential consolidation of the conduits. Step-in risk was present in so-called "SIV" conduits, with partial liquidity lines, but these types of structures have now largely disappeared.

Under Basel 2 the capital charge of the liquidity lines granted to these ABCP conduits are set equal to the capital charge of the pools of underlying assets as if they were on the banks' balance sheet. Therefore prudential consolidation is not an issue: the capital charge is the same regardless of whether the conduit is consolidated or not.

II. <u>Answer to questions related to the consultation</u>

[5] On 23 July 2014 the European Union adopted Directive 2014/91/EU on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions. This directive introduces new rules on UCITS depositaries, such as the entities eligible to assume this role, their tasks, delegation arrangements and the depositaries' liability as well as general remuneration principles that apply to fund managers.

[6] Directive 2011/61/EU on Alternative Investment Fund Managers (AIFMs) has the objective to create a comprehensive and effective regulatory and supervisory framework for AIFMs at the European level. This Directive aims at providing robust and harmonised regulatory standards for all AIFM within scope and enhancing the transparency of the activities of AIFM and the funds they manage towards investors and public authorities.

Q1. What are commenters' views on the four overarching principles? Are there any others that should be included?

Reputational risk should be addressed on a case-by-case basis and not on a too systematic one-size-fits-all one. For example, a bank will not intervene to support a troubled structure if it is so important that the support could threat the bank's solvency. This shows that the reputational risk is secondary with respect to solvency risk. Reputational risk is perceived by the bank as an opportunity cost, which is different for solvency risk under which the bank mobilizes capital. Capitalize reputational risk for the risk of a possible support, is in fact suggesting that the bank will intervene in support and it will paradoxically encourage other investors to think that there will actually support. Is it regulator's willing?

If it is true that step-in risk was an issue during the financial crisis, banks did not support all shadow banking entities that they sponsored but only a narrow scope of entities (for example Money Market funds and ABCP conduits). In addition, the Committee also notes that the reforms introduced by the Committee itself and other regulators as well as changes to the consolidation accounting rules have for the most part addressed this risk and consequently "reduced the likelihood of a bank stepping in to provide financial support but that this risk might not have been completely eliminated".

Therefore there seems to be a disconnect between the need to address a potential residual step-in risk that may not be mitigated by all the reforms already implemented or being considered and a requirements for banks to capture within the prudential regime in one form or another a very large scope of shadow banking entities as implied by the very broad indicators proposed by the Committee. In addition the Committee notes that the reputational risk that a bank intends to mitigate by supporting an entity is already captured in Pillar 2 and therefore the need for additional capital requirement is not intuitive.

Principle 1: "the framework should anticipate the situation after step-in"

As mentioned above, because the regulatory environment has dramatically changed since the financial crisis and consequently the step-in risk has already been largely mitigated, instead of requiring banks to hold capital assuming that they will step-in, one could argue that step-in risk could be prevented by making the cost of stepping-in prohibitive ex post: only banks that at one point in time decide to support and entity beyond their contractual obligations could be required to hold capital for such potential step-in risk putting them at a competitive disadvantage. Incentive to step-in would be therefore drastically reduced. However keeping in mind that in a financial market stress, banks may be subject to political pressures.

Also, this framework may have the perverse effect to create step-in: forcing banks to hold capital against step-in may create expectations for investors that they will be financially supported, where in practice, banks would be most reluctant to provide support by fear of a contagion effect.

Principles 2 and 3: “the framework should be simple and should foster consistent implementation” and “the framework should be conservative, risk sensitive and proportional”

Consistent implementation will be difficult to achieve if the implementation of the framework requires a high degree of judgment to assess whether or not a step-in risk has been properly mitigated, even by taking into account the secondary indicators proposed. The relevant consolidation accounting frameworks already rely on a significant degree of judgment even if they are supported by detailed implementation guidance. Consequently, revisiting the accounting consolidation conclusion by analyzing the very broad primary and secondary indicators proposed is very unlikely to result in a more consistent definition of the regulatory scope of consolidation between banks.

Amending the scope of regulatory consolidation is a drastic measure that does not capture in a risk sensitive manner a bank’s decision to step-in as it does not take into consideration the degree/extent of support that a bank may decide to provide to an entity.

In addition, as mentioned above, the decision to include an entity in the scope of the proposed framework will be difficult to implement in a consistent manner. Therefore the proposed consolidation approach appears to be neither risk sensitive nor foster consistent implementation. Finally, the Committee should not underestimate the difficulty and cost to gather all the required information to perform a full consolidation for entities that are not controlled by a bank.

The framework should not allow using this method only when “step-in is not expected to result in accounting consolidation once materialized”. Trying to assess what impact a potential decision to step-in may have on the accounting consolidation seems difficult to achieve in a consistent manner. It is not the decision to step-in in itself that may trigger an accounting consolidation but instead a change of control. What is more the decision to step-in and to support and entity may also depend on the ability to negotiate new controls right with the other stakeholders.

Regarding proportionality, we believe that the framework starts with a general presumption that step in exists may an indicator be met. These indicators are very general and do not consider any risk-sensitivity or proportionality. A case by case analysis should be more fostered by the Committee with the possibility for banks to provide individual rebuttals.

Q2. What are commenters’ views on the proposed indicators for step-in risk? Are there any additional ones that the Committee should consider?

In different accounting framework (US GAAP and IFRS) most of the primary indicators chosen are already analyzed by banks when they determine whether or not an entity should be included in the scope of accounting consolidation: equity ownership, control (decision making), exposure to variable returns (upfront facilities), implicit support and more generally the purpose and design of the entity (which should consequently be considered as a primary instead of a secondary indicator).

The proposed indicators are not relevant regarding some specific activities. For example, the proposed primary indicators for step-in risk do not fit asset management activities (see Q7).

More, to establish control (see IFRS 10 for instance) reputation risk and commitment risk (see IFRS 10 – paragraph B54[7]) are taken into account among other risks, being considered as a risk that could justify establishing control. It is why many assets have been reconsolidated following the financial crisis notably.

Threshold sensitivity to income variability has been lowered. Therefore why should we change the filter now? A zero-risk approach is unrealistic.

These indicators obviously indicate that a potential step-in risk exists but by themselves they cannot be sufficient to determine if a non-mitigated residual step-in risk exists unless if by design the intent of the Committee is to include a very large scope of entities within this new framework aimed at capturing step-in risk. This would result in a dramatic difference between the accounting and regulatory scope of consolidation.

In particular, the concept of sponsorship taken in isolation cannot lead to the automatic conclusion that a non-mitigated residual step-in risk exist.

One example stands out: among the three elements contained in the definition of sponsorship, the idea that "placing securities in the market" could be an indicator of unmitigated step-in risk cannot be reasonably supported (underwriting agreements define clearly the extent of a bank's commitment: firm or on a best effort basis) and one cannot think of a potential reputational risk that would require a bank to support a failed transaction beyond its contractual obligation.

Similarly, the fact that a bank manages or provide credit and or liquidity support to an unconsolidated entity cannot be in itself a presumption that an unmitigated step-in risk exist.

Finally, the Committee proposes as a primary indicator that "exclusive critical service providers" should be considered. Once again, the fact that an entity provides services that are critical to the bank's operations is not in itself an indicator on unmitigated step-in risk. Dependency on such service providers must be addressed by banks in their Business Continuity Plan and Resolution

[7] An investor may have an explicit or implicit commitment to ensure that an investee continues to operate as designed. Such a commitment may increase the investor's exposure to variability of returns and thus crease the incentive for the investor to obtain rights sufficient to give it power. Therefore a commitment to ensure that an investee operates as designed may be an indicator that the investor has power, but does not, by itself, give an investor power, nor does it prevent another party from having power.

plan and step-in should be assumed only when it is specifically mentioned is such plans (which is very unlikely).

Consequently, additional indicators must be taken into consideration but even the secondary indicators proposed by the Committee appear to remain very broad in order to capture a step-in risk that would only materialize in very exceptional situations, taking into consideration the significant strengthening of the regulatory environment since the financial crisis. For example the concepts of branding, implicit recourse, investor expectations of returns from their investments, investor ability to bear losses or to freely dispose of their financial instruments should not lead by themselves to conclude that an entity is a source of unmitigated step-in risk: once again during the financial crisis, banks have not supported all entities that they have sponsored and investors have actually assumed losses.

The Committee should make it clear that the primary and secondary indicators mentioned should not be considered one by one, but instead entities should be included in the scope of entities subject to capital requirement for step-in risk only when a combination of indicators leads to believe that there is a potential risk that a bank may have to step-in due to its own behavior even if this risk has not and may not actually materialize in the future.

However, it seems nevertheless impractical to define indicators that may result in the implementation of the proposed framework in a manner that is consistent with the overarching principles proposed if a Pillar 1 approach should be chosen.

As a conclusion, we believe that only a Pillar 2 approach should be considered to address such a step-in risk if the Committee believes that the current Pillar 2 guidance on reputational risk and implicit support needs to be strengthened.

Also, we believe that all the indicators are “positive” indicators: we believe that the Committee should have also detailed in the framework indicators that individually preclude step-in, whilst also introducing more proportionality.

Q3. What are commenters’ views on the proposed secondary indicators for step-in risk? Are there any additional ones that the Committee should consider? Should any of them be considered as primary indicators?

With regard to indicator (l), we agree that the disclosure of unconsolidated entities required under IFRS12 might provide regulators with substantive information. We think, however, that it is of foremost importance to keep it as a secondary indicator that is not immediately conclusive. In effect, we know that the current practice can differ from one country to another, from one entity to another in terms of scope of these entities that are not consolidated and that are subject to IFRS 12 disclosure requirement. As a result some institutions may publish a list much larger than others and a case by case analysis should be made to eliminate many of the entities when the scope of the publication has been widely designed.

Q4. What are commenters' views on the different potential step-in risk assessment approaches? Are there any other approaches that the Committee should consider to account for step-in risks?

We regret that all different potential approaches envisaged by the Committee to gauge the magnitude of step-in risk rely on a typical pillar I approach.

Proportionate/full consolidation approach as well as conversion approach cannot fit in with a pillar II approach. Both methods clearly fall within pillar I because they set up a direct link between total assets and capital requirements.

It seems in contradiction with the preliminary statement in the executive summary: it states that the Committee has yet to decide how the proposals will fall within the regulatory framework, including whether they fall within pillar 1 and/or pillar 2. Consequently, some proposals to assess the step-in risk in a pillar II approach would be welcome. Obviously, a close coordination with the works underway on the Supervisory Review and Evaluation process ("SREP") in the EU is important and desirable.

Besides, all the risks of some shadow banking entities are already integrated within the regulatory treatment of banks subject to CRR (LCR, SRF contribution, RWAs requirements), however they do not consolidate these entities. That is why the impact in terms of additional capital charge and liquidity charge for the banks in regard to the additional costs should be assessed before putting in place any automatic consolidation or additional CCF (i.e. if no additional capital or liquidity requirement would be needed by the banking entity through the application of the step-in risk rule, then, there would be no need for a consolidation or an additional CCF).

Q5. What are commenters' views on the proposed mapping between the primary indicators and the potential approaches?

- The scope of regulatory consolidation differs somewhat from the accounting scope of consolidation. The difference may result from (i) a difference in the list of entities entering into each scope and (ii) a difference in the method of consolidation.
  The differences are limited to specific cases. The regulatory capital treatment was generally aligned with accounting treatment. Insurers (and commercial entities) that are currently specifically excluded from the regulatory scope of consolidation while attracting a specific prudential treatment account for a large part of the gap between the scopes. The consolidation approach would widen the gap.
- In Europe, the regulation (EU) No 575/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013 on prudential requirements for credit institutions and investment firms (CRR) in its articles 18 (Methods for prudential consolidation) and 19 (Entities excluded from the scope of prudential) leaves the competent authorities large

discretion to decide whether or not an entity should be included in the consolidation scope.

Thus, the competent authorities do not need extra regulation to require a consolidation method on a case by case basis.

- An extension of the regulatory consolidation would impact the leverage ratio calibration if many entities were identified as step-in risk embedded entities. The application of both primary and secondary indicators to asset management activities and funds under management will be critical in assessing the impact on own funds requirement and on the leverage ratio.

  The European Banking Authority (EBA) is mandated by Article 511 of the CRR to report to the European Commission by mid-2016 on the appropriateness and calibration of a leverage ratio requirement in Europe. The on-going assessments do not take account of the consultation on the step-in risk. This impact should be assessed through the QIS and the forthcoming BCBS consultation on the leverage ratio.
- Economic relevance of step-in risk does not warrant a specific pillar 1 regulation. It should be dealt with on a case by case basis in the course of the regulatory dialogue between banks and their supervisors. If need be it could be tackled as part of pillar 2. The regulatory consolidation is not compatible with a pillar I approach.
- Where a bank has a significant influence relationship with an entity due to it owning 20% or more of the entity, it should not have to compute additional capital charge due to an additional conversion approach. Indeed, the bank will already need capital due to its ownership interest, and the ownership interest in entities is already linked to expensive risk weights.
- When step-in risk is identified, in certain cases, sponsor can chose to fully consolidate or to use conversion approaches, without explaining if it will be a choice for the sponsors.

Q6. What are commenters' views on proportionate consolidation for joint-ventures?

We do not have specific comments.

Q7. What are commenters' views on risks stemming from banks' relationships with asset management activities and funds and the appropriateness of the direction envisaged?

The proposed primary indicators for step-in risk do not fit asset management activities. In particular, the concept of sponsorship, which is used in the context of securitization, is not relevant in the case of asset management: there is no originator and, in turn, no sponsor if we may return the phrase used in §45. Regarding the three elements listed in §46, they do not fit with asset management either:

- Decision making in the management of clients portfolio is totally independent from the management of the AMC and its mother company. The investment decisions are exclusively based on the best interests of the clients as a result of the fiduciary duty an AMC owes to its client investors.

- The second element of the definition of a sponsor relates to operations, i.e. placing securities into the public. AMC use distributors, generally banking networks that place units of funds. In cases of open funds where there are many different distributors there is no risk of step-in, on top of the general (and highly diluted in this case) reputation risk.
- Regarding financial support, the management of the liquidity is part of the job of the AMC and has always been. The higher volatility of many markets and the recent and drastic reduction of market making activities have not favored the liquidity.

  This has led large AMC to negotiate confirmed liquidity lines to be in a position to call on them if necessary. It underlines the fact that responsible entities have already taken decisions to have clear explicit solutions in case of tensions and reduce the step-in risk.

As a consequence we consider that the proposed primary indicators will not help identifying those situations where there might be a step-in risk in asset management activities contrary to what the BCBS states §86 of the consultative paper:

- *"to support an unconsolidated asset management company"*: it is highly improbable that an AM company will need support as it acts as a pure agent and does not engage in prop trade;
- *"to support unconsolidated funds"*: it is highly improbable as well, since funds are separate entities with holders aware of the risks they take (and the return they expect); except for specific cases of explicit guarantee there is no room for step–in risk nor funds support;
- Or both: which is not less improbable in our view.

The BCBS seems to recognize the specificity of asset management as it proposes additional indicators for this activity only (see §87). But it is important to note that most of the mentioned cases are already taken into account in the prudential framework:

- The BCBS is right to point out that when a **guarantee** of capital or performance is granted by an asset manager it should be covered by prudential regulation. In France, performance or capital guarantees are usually offered by banks subject to banking prudential regulation. We support the idea that guarantee be made by banks and that if made by other firms those must be prudentially regulated.
- There are circumstances when the asset manager or the distributor spontaneously indemnifies a client. It is based not on the recognition of any responsibility, but it is made as a commercial gesture towards a client who, though not in a position to introduce a strong legal procedure, complains and asks for repair. This type of **commercial arrangement** to keep a client happy belongs to the operational/reputation risk. Under pillar 2 they are estimated and covered in the banking prudential regulation.

The BCBS further mentions the case of a bank having directly or through an AMC subsidiary a **relevant interest in the fund** other than management fees. The hypothesis in the paper is a bank which would be tempted to extend undue support to a fund in which it has a real interest. We do not believe that loan to the fund is a realistic case of step–in risk with UCITS and AIFs who do not use significant leverage. It may concern hedge funds in their relationship with their prime broker which is an area of specific attention for regulators per se, without having to refer to step-in risk. In conclusion, our opinion about the way to approach step-in risk due to asset management could read as follows:

- **Applying a prudential treatment for those activities that are usually made by banks is appropriate**; it applies to guarantees explicitly offered and confirmed liquidity lines; we consider that the possibility to extend the banking prudential requirements to investment in funds made by asset managers and other quasi financial entities should be investigated; we do not see any other activities that could be concerned.
- **For entities that are consolidated within a prudentially regulated group, bank or insurance, these risks are already taken into consideration**; other risks are consolidated as well under pillar 2 that are of relevance for asset management.
- **Therefore, we think that any additional capital requirement would be inappropriate.** In particular we are strongly opposed to a consolidation approach and a conversion approach which is completely meaningless and unworkable for most AM entities. Unless assets under management are accounted in level 3 and their valuation is eventually questionable, there is simply no question of step-in risk. Most assets management funds have assets that are publicly traded and applying a 1% conversion factor on those assets is completely irrelevant since their valuation will never be questioned.
- **We do not share the view that any extra layer of step-in risk should be linked to banking activities like guarantees**, as suggested in the last bullet point in §88; these activities are prudentially regulated and the same requirements should be extended whenever the counterparty is not a bank nor an insurer, but there is no risk to create step-in risk in relation to those activities which are well documented and disclosed to investors.