Dr. Dieter Wemmer
Member of the Board of Management

Allianz

Via Electronic Submission

Ms Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
U.S.A.

April 10, 2014

RE: Comments on FSB/IOSCO Assessment Methodologies for Global Non-Bank SIFIs

Dear Ms Murphy:

As a large investor and owner of PIMCO, Allianz SE has a strong interest in resilient financial markets and regulatory regimes fostering financial stability. We are pleased to provide the Commission with our comments in response to the FSB and IOSCO proposal to develop methodologies to assess global non -bank SIFIs. Allianz SE fully supports PIMCO's letter, dated April 7, 2014 to the FSB and IOSCO proposal which we understand has been made available to you and to which reference is hereby made.

Please feel free to contact us if we can provide any assistance to you in the further evaluation of these very important issues.

Sincerely,

Dieter Wemmer

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Encl

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FSB/IOSCO Consultation on Assessment Methodologies for Identifying Non Bank Non Insurer Global Systemically Important Financial Institutions

Allianz SE Reply

Allianz SE appreciates the opportunity given by the FSB and IOSCO to respond to the consultation on Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions (the "**Consultation**"). As a large investor and also owner of asset managers Allianz Group has a strong interest in resilient financial markets and regulatory regimes fostering financial stability. Allianz SE has contributed to the replies of PIMCO, the IIF and EFAMA which it fully supports and to which reference is hereby made. In addition, we would like to make the following observations from an Allianz Group perspective:

I General Comments

1. Allianz endorses the numerous references made in the Consultation to the specificities of the business model of asset managers and investment funds (agency model, high degree of substitutability, strong regulatory framework including transparency and reporting requirements). The agency business model of asset managers generally reflected in the regulatory prohibition to trade on own account with investor's capital is rightly identified as the key reason why asset managers are not a source of systemic risk.

2. In financial stability regulation, we believe that a sharp distinction ought to be made between **systemic relevance** (where an entity is passively exposed to external shocks) and **systemic riskiness** (where such entity is the source of a shock to the financial system. Only the latter has to be addressed by "disrupter"-specific regulation whereas the former is the **realm of general prudential regulation** where similar rules should apply (and be enforced) market-wide across jurisdictions to avoid regulatory arbitrage.

3. Particularly with regard to investment funds[1] (which also the Consultation acknowledges to have served as shock absorbers during crisis and where the fund is the **mere "legal shelf"** through which activities are conducted), the **risks for financial stability** of an approach which would rely on **designating individual entities** and applying additional policy measures to such entities on a blanket basis becomes evident: Such approach inevitably creates an **un-level playing field**, moral hazards (potentially too big to fail) and market distortions (in particular if designation of further entities is effectively put in the hand of national regulators). **More severely**, designating certain entities as Non-Bank Non-Insurer Global Systemically Important Financial Institutions ("**NBNI G-SIFIs**") (and applying additional and costly policy measures to such entities and not their competitors) will result in "systemic" **activities shifting from a G-SIFI to other, non-designated (and potentially unregulated) entities**[2] making such activities less visible.

4. Historical evidence does not suggest that the "**size**" of an investment fund has threatened financial stability. The typically cited Long Term Capital Management Hedge Fund stood out with respect to its opaqueness, low degree of external monitoring and high degree of leverage. As all financial crises have involved debt that has become dangerously out of scale, **regulatory focus should be on activities and risk management techniques rather than entities**, i.e. potential deficits in the general prudential framework governing the asset management industry and in particular the **coherent global application** of

[1] Any reference to investment funds shall include segregated accounts.
[2] Entities is used in an untechnical manner and refers to investment funds as well as segregated accounts.

existing regulation. **Arbitrarily selecting a USD 100bn threshold produces false positives and false negatives**.

5. Nowhere in the G20 directive is the FSB required to designate asset managers. The characteristics of the industry, in particular the **high degree of substitutability** and **mobility of investors** demonstrate that entity targeted designation and policy measures would be ineffective. IOSCO/FSB should therefore work with specific national regimes to address potential concerns about financial stability and recommend enhancements to national activities-based regulation where necessary (as it was successfully done in the case of EU and US constant net asset value money market funds).

6. Any regulation has to comply with the **rule of law**, i.e. must be enacted in a democratic, transparent manner based on **a proven need** that the suggested measures are necessary and suitable to achieve a certain aim. It is **extremely challenging** to assess the appropriateness of the proposed methodologies and to make detailed comments on the proposed indicators of systemic relevance without knowing which implications a NBNI G-SIFI designation would actually have for the concerned financial entity, i.e. **not knowing the measures** which would be enforced on a NBNI-GSII.

7. Any new regulation has to take existing prudential regulatory regimes into account. EU UCITS funds and US Investment Company Act funds are **subject to extensive regulation** (rules on diversification, eligible assets, issuer concentration limits, restrictions on borrowing and the use of derivatives, liquidity, daily valuation, extensive disclosures, segregation of assets and depository). Such regulation does not only serve investor protection but, on a collective level, has positive repercussions on the stability of the financial system as a whole. Institutional investor funds/segregated accounts are also indirectly regulated through investment restrictions/guidelines applying at investor level.

8. To foster financial stability a multitude of **financial market infrastructure** related measures have been introduced since the crisis, most notably market transparency has been improved by moving OTC derivatives trading onto organized platforms with counterparty risk managed through a Central Counterparty (CCP). Close monitoring (also with regard to differences in implementation) may be necessary to ensure that risk management systems are fully operative and participants understand the functioning and risks associated with CCPs.

9. Although Allianz welcomes the approach taken by the FSB to exclude NBNI financial subsidiaries of insurance groups which have been assessed by the IAIS on a consolidated basis, such entities (and the funds/assets managed by them) may not be subject to stricter regulation than **NBNI entities not belonging to a G-SII group**. Otherwise regulation would, again, create an uneven playing field between market participants which is not justified by any additional risk posed by such NBNI entities.

10. Asset managers owned by a G-SII should neither have an impact on such G-SII's designation criteria (systemicness indicators) nor trigger additional capital requirements for such G-SII (given that, as acknowledged by the Consultation, asset management is an agency business in which the fund manager does not own the assets of the fund and delivers a pure service, only).

II Issues highlighted by the Consultation

1. Systemic Risks and transmission mechanisms

Q1-1. In your view, are the three transmission channels identified above most likely to be the ones transmitting financial distress of an NBNI financial entity to other financial firms and markets? Are there additional channels that need to be considered?

No. These transmission channels have originally been identified when scrutinizing the banking industry and have not been shown to be relevant with regard to certain NBNI business models. For example, substitutability is not an issue for the investment fund industry since investment funds, by the nature of their business, are in fact highly substitutable.

2. High-Level framework for identifying NBNI G-SIFIs

Q2-1. Does the high-level framework for identifying NBNI G-SIFIs (including the five basic impact factors) adequately capture how failure of NBNI financial entities could cause significant disruption to the wider financial system and economic activity? Are there any other impact factors that should be considered in addition to those currently proposed or should any of them be removed? If so, why?

We believe that the high level factors do not address activities based risks. Moreover, the Consultation has provided no justification for applying this framework to investment funds, which are among the safest and most stable financial entities, as shown during the 2008-2009 market crisis. We also believe that the methodology has a **major shortcoming** which is that no distinction is made between **systemic relevance** (where an entity is passively exposed to external shocks) and **systemic riskiness** (where such entity is the source of a shock to the financial system. Such distinction is however, necessary as it has consequences for the type of regulatory measure to be applied. Entity specific measures (G-SIFI regulation) is required where an entity is the **source of a shock** to the financial system. However, entity specific regulation (and G-SIFI) designation fails to have an impact on financial stability where an entity is passively exposed to systemic shocks created elsewhere.

- **Size** is only of limited value in assessing threats to financial stability emanating from financial institutions other than banks:

  - Size may potentially even mitigate systemic risk. Large portfolios create significant diversification benefits and portfolio effects, and hence provide shock absorbers to systemic risk, particularly when geographic, client and counterparty diversification are take into account. Thus during the last financial crises large funds with institutional and retail investors have acted as shock absorbers.

  - Two entities of the same size can present widely varying risk profiles depending on their use of leverage. The consultation paper rightly notes, “the importance of a single entity for the stability of the financial system generally increases with the **scale of financial activity** that the entity undertakes”.

  Consequently, it would be ineffective for the purpose of identifying potential G-SIFIs to screen investment funds exclusively on the basis of their size. A large and well-diversified fund with little leverage, such as UCITS or US RIC, is unlikely to pose systemic risk. To the contrary, smaller but highly leveraged funds that are potentially more relevant from a systemic point of view would not meet the materiality threshold. **The USD 100bn “materiality threshold”** established by the Consultation thus appears ill-suited to identify risks to financial stability as it would produce falls negatives and positives. **The methodology should therefore first look to leverage before considering size**.

- **Substitutability:** We endorse the approach in the Consultation that substitutability is not a systemic risk transmission channel for investment funds. Investment funds and their sponsors exit the market regularly in an orderly manner without any systemic impact or any need for government intervention.

- **Complexity:** An effective risk-sensitive analysis should focus on the relative complexity and opacity of an entity's business. Funds operate a simple business model reflected in lean legal structures and plain balance sheets. They allow investors to invest in capital markets with the benefit of economies of scale and risk diversification. A EUR/USD invested is a EUR/USD lost. There is no first mover advantage (the exception of constant net asset value money market funds is not considered here as such funds are now subject to strict regulation in the US/EU effectively rendering the business model unattractive).

- **Interconnectedness** as reflected in leverage (including "economic leverage" under derivative trading) is certainly the most relevant impact factor. UCITS regulation and AIFMD regulation in the EU and regulation of US RICs strictly limit leverage and borrowing (future obligations must be "covered" by unencumbered, liquid assets that are marked-to-market daily; no borrowing unless total assets less liabilities other than borrowing is three times greater than total borrowings (US)).

- **Indicator weights:** We would strongly object to an equal weighting of indicators as most indicators are somewhat correlated.

Q2-2. Is the initial focus on (i) finance companies, (ii) market intermediaries, and (iii) investment funds in developing sector-specific methodologies appropriate? Are there other NBNI financial entity types that the FSB should focus on? If so, why?

Although they are already subject to a specific regime, we think that CCPs should also be monitored carefully. CCPs will take on board more counterparty risks and therefore are a new potential source of concentration and systemic risks. CCPs could spread losses from a limited group of financial market intermediaries (in particular, clearing members) to the wider economy.

3. Operational framework for NBNI G-SIFI methodologies

Q3-1. Is the proposed scope of assessment outlined above appropriate for operationalizing the high-level framework for identifying NBNI G'SIFIs? Are there any practical difficulties associated with the proposed scope of assessment?

We believe there is too high a degree of subjective assessment or supervisory judgment. We are particularly concerned that the **designation process** is effectively dependent on the highly discretionary judgement of national competent authorities opening the doors for 'gold-plating' (i.e. application of stricter materiality thresholds), unlevelled playing fields and regulatory arbitrage.

Q3-2. In your view, are the above proposed materiality thresholds (including the level) for the NBNI financial entity types appropriate for providing an initial filter of the NBNI

financial universe and limiting the pool of firms for which more detailed data will be collected and to which sector-specific methodology will be applied? If not, please provide alternative proposals for a more appropriate initial filter (with quantitative data to back-up such proposals).

Reference is made to our general concerns with regards to 'size' as an indicator for systemic risk under Q2-1 above. The Consultation does not provide any arguments or data to support the proposed materiality thresholds or explain how 'balance sheet total assets', 'assets under management (AUM)' and 'gross notional exposure (GNE)' indicate potential risk to the global financial system.

Q3-3. Are there any practical difficulties in applying the materiality thresholds?

As stated above, two entities of the same size can present widely varying risk profiles. In our view, the materiality thresholds present an inaccurate of view of investment funds and their contribution to systemic risk. The materiality thresholds are arbitrary in that they are not based on actual observed contributions to risk and will inevitably lead to designation of entities that do not present actual systemic risks.

Q3-4. In your view, what is the appropriate threshold level, taking into account the range given above (USD 400-600 billion in GNE), for hedge funds? Please also provide reasons with data to back it up.

Cf. Q2-1 on our concerns regarding such thresholds.

Q3-5. Do you think that it would be beneficial to set additional thresholds based on "global activity"? If so, please explain the possible indicator and the level on which materiality thresholds should be set (with reasons for selecting such indicator, the level and any practical challenges).

Given that we are not convinced that the "global activity" of an investment fund is a relevant criterion to assess its systemic importance, we do not think that it would be appropriate to set additional materiality thresholds based on "global activity" indicators.

4. Sector specific methodologies (1): Finance companies

Given that Allianz Group does not control any finance companies (as defined by the Consultation) we have no comments to make.

5. Sector specific methodologies (2): Market intermediaries (Securities broker-dealers)

We have no comments to make.

6. Sector specific methodologies (3): Investment funds

Q6-1. In your view, does the proposed definition of investment funds provide a practical basis for applying the specific methodology (i.e. indicators) to assess the systemic importance of NBNI financial entities that fall under the definition?

The definition covers very disparate categories of funds. We believe that the focus should primarily be on highly leveraged investment funds of a significant size. Concerning **separately managed accounts**, we would like to remind the FSB that these accounts are regulated (both by general asset management regulation but also by each client's regulation, e.g. pension funds or insurance regulation). Portfolios are generally conservatively managed (typically no leverage due to pension regulations, no investments in large concentrations of illiquid securities).

Q6-2. Does the above description of systemic importance of asset management entities adequately capture potential systemic risks associated with their financial distress or disorderly failure at the global level?

As outlined before these potential transmission channels are only relevant in the case of highly leveraged funds of a significant size (hence, the importance of taking these two indicators into account in the methodology aiming at identifying which investment funds should be considered as G-SIFIs). A contrario, we believe that there is a strong case to exclude highly regulated investment funds (such as UCITS or regulated AIFs in Europe and US RICs) where there is already a strong focus on diversification and meeting investor liquidity expectations which mitigate the possibility of mass redemptions. **It is thus impossible for floating NAV, unlevered investment funds to "fail"**. The worst that can happen is for a fund's value to go to zero; this risk is well-documented and understood by investors and is antithetical to the concept of guaranteed bank deposits. Further, because the fund is a separate legal entity, any obligations of the fund cannot cause a claim on any other assets of other funds or the asset manager itself.

Q6-3. Which of the following four levels of focus is appropriate for assessing the systemic importance of asset management entities: (i) individual investment funds; (ii) family of funds; (iii) asset managers on a stand-alone basis; and (iv) asset managers and their funds collectively? Please also explain the reasons why you think the chosen level of focus is more appropriate than others.

We reiterate that we do not believe that entity-level designation of investment funds is an appropriate way in which to reduce systemic risk, and instead advocate that regulators consider an industry-wide, activities-based approach to reducing systemic risk. However, if the FSB insists on taking an entity-level approach, we believe that the Consultation has rightly identified **option i** (individual investment funds) as the appropriate one:

- As the Consultation rightly acknowledges **option iii** (asset managers on a stand-alone basis) is inappropriate to the issue of systemic risk: Asset managers are not direct participants in the capital markets. They do not act as lenders or counterparties, and accordingly they have very small balance sheets, and limited interconnections and none with respect to the assets they manage. Therefore, asset management entities present no systemic risk at the company level.

- Regarding **option iv** (asset managers and their funds collectively) we have no specific information that would validate the Consultation's view that a 'reputational crisis' in which a negative incident with regards to a certain fund damages the reputation of the respective asset manager and could lead to a 'run' on all of its investment funds under management. The distinctiveness and the independence of the various funds and their respective investor base however, render such an event extremely unlikely. Further, existing regulations protect both the liquidity needs of investors and the stability of asset prices. Additionally, there are resilient mechanisms in place to dampen any potential systemic impact of a potential massive withdrawal of funds (asset managers may temporarily implement specific liquidity management tools such as swing pricing, antidilution levies, redemption gates, side-pockets, redemptions in kind or temporary suspensions). Hence, despite the very low probability of a run occurring in the first place, even if a run on all the funds of a certain asset manager should take place the industry has statutory rules and circuit-breaking mechanisms in place which would prevent such a run from having systemic consequences.

- **Option ii** (family of funds) A family of funds does not necessarily present any higher financial risk than a single fund. The funds are separate legal entities with separate assets and different counterparties. Most importantly the investors in each fund are different, and are very much independent. This is also a key differentiator between investment funds and banks: Whereas every investment fund of an asset manager has a separate balance sheet and a separate set of investors banks operate with a single balance sheet and a single set of shareholders and creditors thus making them much more susceptible.

Q6-4. Should the methodology be designed to focus on whether particular activities or groups of activities pose systemic risks? If so, please explain the reasons why and how such a methodology should be designed.

As already explained above, we believe that the scale of activities of an investment fund, which is a reflection of its leverage and size, is the determining factor in assessing its potential systemic relevance.

Q6-5. Are the proposed indicators appropriate for assessing the relevant impact factors? If not, please provide alternative indicators and the reasons why such measures are more appropriate.

Cf. Q6-2 above.

Q6-6. For "cross-jurisdictional activities", should "the fund's use of service providers in other jurisdictions (e.g. custody assets with service providers in jurisdictions other than where its primary regulator is based)" be used?

We do not believe that the "fund's use of service providers in other jurisdictions" is necessarily a meaningful indicator of its systemic relevance. To the contrary, we would argue that a large fund operating in different countries is less risky than a large fund operating in a single country, as geographical diversification could help reduce the risk borne in each country.

Q6-7. Is the definition of "net AUM" and "GNE" appropriate for assessing the "size" (indicators 1-1 and 1-2)?

Cf. our comments under Q2-1. Above.

Q6-8. Is the definition of "investment strategies" sufficiently clear for assessing the "substitutability" (indicator3-3)?

We do not believe that the definition of “investment strategies (or asset classes) with less than 10 market players globally” is a workable metric:

1. An investment strategy is not consistently defined across the industry and many strategies overlap. For example, an emerging market fund will overlap with a global growth fund and a global bond fund and a global currency fund.

2. Secondly, with regards to asset classes, if there are fewer than ten funds investing in a particular asset class it is not a direct measure of systemic risk. To the contrary, given the low barriers to entry and highly competitive nature of the investment fund business, such a small number of funds in an asset class probably indicates that the asset class is irrelevant to the global financial system because there is too little value in it.

We therefore propose that this metric be carefully reconsidered. We do agree that if a single fund was the sole or majority investor in a given market, then the liquidation of that fund would cause extreme stress in that market. However, such a scenario is highly improbable in a market of any global relevance and existing regulations both at the fund and the market level (e.g. shareholder limitations) make such a case virtually impossible to consider.

Q6-9. Would collecting or providing any of the information included in the indicators present any practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be collected or provided instead.

In order to minimize these costs, any data collection by regulators should as much as possible be based on already existing statutory reporting (e.g. AIFMD and UCITS reporting requirements).

Q6-10. Are there additional indicators that should be considered for assessing the relevant impact factors? For example, should “the fund’s dominance in a particular strategy (as measured by its percentage of net AUM as compared to the total AUM)” also be considered for “substitutability”? Similarly, should “leverage” or “structure” of a fund also be considered for assessing “complexity”? Please explain the possible indicators and the reasons why they should be considered.

We strongly believe that in the context of investment funds posing a global systemic risk the only relevant transmission channel is leverage and this is where attention should be focused. Thus, any methodology and any indicator should be centred around the identification of leverage. Additionally, we think regulators must consider the robustness of the regulatory regime to which investment funds are currently subject.

Q6-11. Should certain indicators (or impact factors) be prioritized in assessing the systemic importance of investment funds? If so, please explain which indicator(s) and the reasons for prioritization.

Cf. above.

7. Guiding methodology for all other NBNI financial entities

Q7-1. In your view, does the approach set out in this section adequately identify as a “backstop” any potential G-SIFIs not captured by sector-specific methodologies?

No comments.

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