

MEMO# 30928

October 26, 2017

Basel Committee Issues Final Guidelines on Identification and Management of Step-In Risk

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TO: ICI Members
ICI Global Members
Bank-Affiliated Member Advisory Committee
ICI Global Regulated Funds Committee
Money Market Working Group SUBJECTS: International/Global
Money Market Funds RE: Basel Committee Issues Final Guidelines on Identification and Management of Step-In Risk

Earlier this week, the Basel Committee on Banking Supervision (BCBS or Committee) published final guidelines on the identification and management of step-in risk.[\[1\]](#) This memorandum briefly highlights aspects of the guidance that may be of interest to bank sponsors of regulated funds.

Background

Since 2015, the BCBS has been working to facilitate the identification of unconsolidated entities that could entail significant step-in risk for banks. It describes “step-in risk” as the risk that a bank may provide financial support to an entity beyond or in the absence of any contractual obligation to do so, should the entity experience financial stress. The BCBS issued two consultations on a proposed framework, one in December 2015 and the other in March 2017. ICI Global’s comment letters raised concerns about the possible treatment of regulated funds under the proposed framework. Our first letter discussed the many reasons why regulated funds sponsored by banks or bank affiliates—both regulated money market funds and regulated stock and bond funds—are unlikely to present significant step-in risk.[\[2\]](#) Our second letter acknowledged several improvements to the proposed framework but urged the Committee to do more to distinguish between bank relationships with unconsolidated entities that pose significant step-in risk and bank relationships with regulated funds, where step-in risk is remote.[\[3\]](#)

BCBS final guidelines

With very limited exceptions, the final guidelines mirror the framework proposed by the

BCBS in its March 2017 consultation. Of note for bank sponsors of regulated funds:

- Unlike the March 2017 proposed framework, the final guidelines do not appear to require a bank to scrutinize each of the entity types listed in Annex 2—which list includes mutual funds, money market funds, and exchange-traded funds. Rather, the guidelines state that Annex 2 identifies entity types that “would generally be included” in a bank’s assessment and “is provided for illustrative purposes.” See paragraph 23 on page 5 and Annex 2 on page 22.
- Section 2.2.3 of the final guidelines (entitled “relationships between the bank and the entity that prompt inclusion in the initial set of entities”) includes the following new language: “Asset management companies and the associated assets under management that are not consolidated for regulatory purposes may bear step-in risk for the banks. Those should therefore not be excluded a priori from the identification process.” See paragraph 26 on page 6.
- Under the final guidelines, a bank will develop its own policy for determining the materiality of any step-in risk presented by an unconsolidated entity, subject to supervisory review. See paragraph 29 on page 6. This differs from the March 2017 proposed framework, which contemplated that supervisors could establish “absolute and/or relative quantitative materiality thresholds and associated qualitative considerations for their specific jurisdictions.” (For each material entity/group of entities that pose significant step-in risk, the bank will be required to report to its supervisor regarding (i) the nature of the risk and (ii) the action taken by the bank to limit, mitigate or recognize this risk.)
- Despite ICI Global’s comments, the BCBS did not modify its discussions of “liquidity stress/first mover incentive” in Section 3.5 (which injects some skepticism about certain variable NAV funds) and “historical dependence” in Section 3.10 (which highlights instances of support to money market funds during the financial crisis without acknowledging significant post-crisis reforms to such funds).

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endnotes

[1] BCBS, *Guidelines: Identification and management of step-in risk* (October 2017), available at <http://www.bis.org/bcbs/publ/d423.pdf>.

[2] Letter to BCBS from Dan Waters, Managing Director, ICI Global, dated March 17, 2016. The letter is available at <https://www.iciglobal.org/pdf/29778.pdf>.

[3] Letter to BCBS from Dan Waters, Managing Director, ICI Global, dated May 15, 2017. The letter is available at <https://www.iciglobal.org/pdf/30705a.pdf>.

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