Consultation Agenda

Standard-Setting Project: Systemic Risk Management in the Asset Management & Custody Activities industry

Overview of the Consultation Goals

During its Dec. 4, 2019 meeting, the Sustainability Accounting Standards Board (SASB) approved a standard-setting project to re-evaluate the Systemic Risk Management disclosure topic and corresponding accounting metrics included in the SASB standard for the Asset Management & Custody Activities industry. The initiation of this project was largely driven by stakeholder feedback provided to SASB since codification of the standards in November 2018 as well as by recent regulatory changes. Specifically, the U.S. Financial Stability Oversight Council (FSOC) in January approved an "activities-based approach" to address systemic risk as it pertains to nonbank financial institutions and in late 2018 the U.S. Securities and Exchange Commission (SEC) rescinded the proposed rule under which funds would report aggregate liquidity classification information about their portfolios.

In late January 2020, SASB's project team began conducting consultation with key market participants—including corporate reporters, investors across asset classes and strategies, and subject matter experts—to identify areas in which SASB can improve how it has defined the scope of the Systemic Risk Management disclosure topic and the effectiveness of the associated accounting metrics.

In re-examining the scope of the disclosure topic, SASB's intent is to capture the important role asset/wealth managers and custodian banks play in the financial system and the potential social externalities that may result from failure to manage risks associated with relevant activities. We are looking to explore operational and business risks faced by asset managers, wealth managers, and custodian banks. Specifically, SASB is looking to explore the entity-level (as opposed to the fund-, portfolio- or security-level) risk associated with management of liquidity risk, collateral management and counterparty risk in Securities Financing Transactions (SFTs), credit risk, and market risk. SASB's goal is to provide related performance metrics that will be decision-useful to investors in assessing the quality of risk management and the magnitude of potential risk exposure at individual nonbank financial institutions.

SASB is *not* looking to get involved in a broader discussion of systemic risk management or debate the impact of asset/wealth managers and custodian banks on the financial system. SASB does not position itself as an expert in systemic risk management and will not provide a view contrary or additive to that currently established by global regulators.

Instead, SASB seeks to understand how, in the context of the existing regulatory environment, it can provide decision-useful information to investors regarding risk management.

In revisiting the performance metrics associated with this topic, SASB seeks market views on the usefulness of the current metrics—both conceptually and from a technical standpoint (i.e., the clarity and applicability of technical guidance). We are also interested in recommendations for updates to the existing metrics as well as suggestions for additional or alternative metrics that could be decision-useful for investors in assessing an entity's performance on the issue.

At the end of the consultation period, SASB will publish a summary of comments received from market participants without attribution to individuals or their affiliated organizations.

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Topic scope questions

1. SASB aims to capture this issue through the lens of the business risk it can present to an individual entity, as opposed to considering the concentration of risk in the broader system. Within an entity, SASB is looking to assess risk to a manager or a custodian, rather than risk at a portfolio-, fund-, account-, or security-level. Do you agree with this approach?

   Expected outcome: Understand the scope of the disclosure topic.

2. Do you agree that failure to manage liquidity risk, collateral and counterparty risk in SFTs, credit risk, and market risk may not only pose business risk to an entity but may also present negative social externalities?

   Expected outcome: Understand social implications of risk management for the industry, i.e., is it an ESG issue or purely a business issue?

3. From the standpoint of the SICS industry structure (ESG issues faced by companies and externalities created by their operations), where do custody activities fit more naturally? — i.e., in Asset Management, Investment Banking, or Corporate Banking?

   In the context of business activities and entity-level risk management, what are the relevant differences and similarities among asset managers, wealth managers, and custodian banks?

   Expected outcome: Formulate an informed view on the best fit for the custody activities segment within the Financials sector of SICS. Understand whether the scope of disclosure for this topic as it relates to asset managers, wealth managers, and custodian banks should be different.

Measurements questions

4. To measure 1) quality of management of and 2) level of exposure to liquidity, counterparty, credit, and market risk through the lens of an impact on the entity, what accounting metrics would be

most decision-useful to investors? For which activities would it be relevant to measure involvement? (e.g., SFTs, derivative underwriting, variability in investment strategies, asset classes, and client types)

How do each of these activities and exposure channels apply in each of the segments within Asset Management & Custody Activities industry?

Expected outcome: Understand the specific activities and/or exposure channels most relevant to the topic. Understand what aspects of the topic would apply to which segments of the industry as a whole and, therefore, what potential metrics would be relevant to asset managers but not custodian banks, and vice versa.

Note: The scope of the topic may include such aspects as interconnectedness, substitutability, liquidity, and leverage, and cover both primary activities of companies in the industry (asset/wealth management and custody services) as well as non-primary activities such as SFT and derivatives transactions.

5. Considering liquidity and leverage for assets under management, how could risk within individual portfolios/strategies spiral up to the manager-level? How can performance on this aspect of the issue be measured at the entity level?

   Are there certain asset classes, product categories, or investment strategies where liquidity or leverage may present more (or less) risk? What metric could SASB use to capture these differences for an entity? (e.g., amount of AUM in specific asset class or product type)

   Asset liquidation is one of three transmission channels identified by the FSOC's interpretive guidance focused on the activities-based approach. Is it feasible to quantitatively measure asset liquidation risk—e.g., balancing liquidity of securities in funds and redemption rights of owners (lockup periods, etc.)?

   Expected outcome: Understand whether measuring liquidity, leverage, and redemption risk at the entity level is relevant and feasible. Identify and/or refine accounting metrics for the Exposure Draft of the standard.

6. Do you agree with removal of metric "FN-AC-550a.1 – Percentage of open-end fund assets under management by category of liquidity classification"? Is there an alternative metric, from the activities or principles standpoint, that would be relevant to measure performance on this aspect of the issue at the entity level?

   Expected outcome: Obtain consensus with respect to metric FN-AC-550a.1 and develop alternatives for the Exposure Draft.

7. Do you find metric "FN-AC-550a.2 – Description of approach to incorporation of liquidity risk management programs into portfolio strategy and redemption risk management" relevant and

useful to help investors assess entity-level risk? How can SASB improve the global relevance and general decision-usefulness of this metric?

Expected outcome: Develop an updated technical protocol for a metric focused on liquidity risk management for the Exposure Draft.

8. Consider ETF products specifically and the potential liquidity mismatch issues related to these products. Is there a link between systemic risk (per the scope outlined above) and exposure to ETFs? Would it be relevant and decision-useful for SASB to incorporate a metric measuring entity exposure to ETFs?

   Expected outcome: Understand whether ETF exposure is a relevant measure of portfolio liquidity risk. Develop an accounting metric for the Exposure Draft of the standard.

9. Can involvement in SFTs contribute to systemic risk and result in entity-level business risk? Does this risk differ in situations when an entity plays the role of an agent in a tri-party agreement, where collateral indemnity may be provided? Does it differ in situations when an entity uses SFTs as a source of leverage within client portfolio/funds? Are both scenarios relevant in the scope of this disclosure topic (i.e., is there an entity-level risk in both cases)? How does it differ for asset managers and custodian banks?

   Expected outcome: Understand whether and how the scope of the disclosure topic should capture exposure to SFTs.

10. Does metric “FN-AC-550a.3 - Total exposure to securities financing transactions” adequately capture performance based on your views related to the item above? As it applies to companies in SASB’s Asset Management & Custody Activities industry, is alignment with Basel III appropriate for calculating SFT exposure? What frameworks do asset managers and custodian banks use to measure SFT exposure? Do they report this data publicly and is it reported in a useful format?

    Does the metric FN-AC-550a.3 need revision? What should be included in its scope?

    Expected outcome: Understanding whether removal or revision of the metric FN-AC-550a.3 is needed. Fleshing out potential alternative accounting metrics focused on the SFT for the Exposure Draft of the standard.

11. Does involvement in underwriting of credit derivatives potentially contribute to systemic risk that may result in entity-level business risk? Does the issue arise from exposure to derivatives at the entity level (corporate derivative underwriting) or at the portfolio/strategy level (which then rises to the entity level)? Do answers to the previous questions differ based on the country of domicile of the entity and/or funds/portfolios?

    Expected outcome: Understand the relevance of exposure to derivatives as a measure of business risk for companies within the industry.

12. Does metric "FN-AC-550a.4 - Net exposure to written credit derivatives" adequately capture performance based on your views related to the item above? As it applies to companies in SASB's Asset Management & Custody Activities industry, is alignment with Basel III appropriate for calculating derivatives exposure? What frameworks do asset managers and custodian banks use to measure derivatives exposure? Do they report this data publicly and is it reported in a useful format?

    Expected outcome: Understanding whether removal or revision of the metric FN-AC-550a.4 is needed. Fleshing out potential alternative accounting metrics focused on exposure to derivatives for the Exposure Draft of the standard.

13. From the standpoint of providing decision-useful information to investors who would assess the riskiness of individual entities, what are the most useful quantitative indicators SASB should consider using to capture the entity-level risks within the scope of this disclosure topic?

    Are these metrics already publicly disclosed in some shape or form such that SASB could leverage them in the industry standard (considering that SASB is trying to identify a minimal set of metrics rather than ask for comprehensive breakdown of performance at the fund or security level)?

    Expected outcome: Understand the gaps in publicly available information on the issue. Identify metrics potentially useful to investors in assessing performance on this aspect of the topic.

Broader implications (if time permits)

14. Does SASB's approach to systemic risk/business risk management for the Commercial Banks, Investment Banking, and Insurance industries need to be very closely aligned with that for the Asset Management industry? Or are regulatory approaches to systemic risk in banking/insurance significantly different enough to justify differences in the SASB topics as well?

    Expected outcome: Assess potential research and standard-setting projects related to the Systemic Risk Management general issue category as it manifests in other SASB industry standards.