IAA INVESTMENT ADVISER ASSOCIATION

September 21, 2016

Via Electronic Mail (fsb@fsb.org)

Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002, Basel, Switzerland

Re: Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities

Dear Ladies and Gentlemen:

The Investment Adviser Association ("IAA")[1] appreciates the opportunity to comment on the FSB's recent consultation on proposed policy recommendations to address structural vulnerabilities from asset management activities.[2] Because the IAA's members are primarily U.S. asset management firms, we have a great interest in the FSB's work on this topic.

We appreciate that the FSB has moved away from pursuing the designation of particular asset managers as non-bank non-insurer global systemically important financial institutions (G-SIFIs). The FSB is correct to recognize that traditional asset management is not a source of systemic risk because asset management is fundamentally an agency business where the asset manager is neither a counterparty to nor a guarantor of its clients' investment risks.

We also appreciate that, in a number of places, the FSB is recommending that IOSCO review its existing guidance and enhance it as appropriate. For most aspects of the asset management business, securities regulators are the primary functional regulator. As a global organization of securities regulators, IOSCO is in the best position to encourage local securities regulators in each jurisdiction to study these issues and develop approaches that are both appropriate in light of the purposes and structure of the overall regulatory scheme for asset management in that particular jurisdiction and consistent with other regulatory approaches to the greatest extent possible.

This letter has two principal parts. In the first part, recognizing that the FSB is studying these issues globally and that different jurisdictions have addressed the issues in varying degrees, we provide a brief summary of regulatory developments that are currently underway in the

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[1] The IAA is a not-for-profit association that represents the interests of investment adviser firms registered with the U.S. Securities and Exchange Commission. The IAA has approximately 600 member firms that collectively manage nearly $20 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations, and many of our members are part of a global financial services firm. For more information, please visit www.investmentadviser.org.

[2] *Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities* (the "Consultation"), published by the Financial Stability Board (the "FSB"), *available at* http://www.fsb.org/wp-content/uploads/FSB-Asset-Management-Consultative-Document.pdf.

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United States at the Securities and Exchange Commission (the "SEC"). We believe that the SEC's initiatives are intended to address the same underlying concerns outlined in the Consultation. In the second part, we discuss the FSB's specific recommendation with respect to measuring leverage in funds. We generally favor greater harmonization with respect to reporting obligations, recognizing that asset managers operating in multiple jurisdictions expend considerable resources meeting local reporting requirements. For a number of reasons, however, we believe that the FSB's recommendation that IOSCO develop a single simple way to measure leverage is overly ambitious. In our view, it will prove to be very difficult to reach consensus on a single methodology to calculate leverage that would be appropriate for all types of funds in every jurisdiction around the world, and IOSCO's time and energy would be better spent on a comprehensive survey on that topic.

I. The SEC's Current Rulemaking Agenda with respect to U.S. Asset Managers

When considering the policy recommendations in the context of U.S. asset managers, as the IAA has previously commented to the FSB,[3] it is imperative to fully evaluate the impact of current regulatory developments with respect to the U.S. asset management industry as a result of the Dodd-Frank Act and other market developments. The SEC, as the primary regulator of U.S. asset managers and the investment fund industry, has begun to undertake several substantial rulemaking initiatives that are intended to enable the SEC to better monitor and address risks across the asset management industry in the U.S. These initiatives include regulatory proposals to strengthen registered investment companies' management of liquidity, better address risks related to registered investment companies' use of derivatives, enhance data reporting, plan for business continuity and the transition of client assets, and stress test large registered investment companies and large asset managers.

Liquidity Management. As a practical matter, asset managers take significant steps to address liquidity risks and ensure that they can honor redemptions, particularly in open-end funds, and many asset managers have enhanced these practices since 2008. In addition, the SEC has proposed a comprehensive set of rules designed to mitigate the liquidity risks associated with investment strategies used by certain open-end funds.[4] If adopted, the proposed rules would require long term open-end funds, including mutual funds and exchange-traded funds (ETFs), to adopt liquidity risk management programs and provide enhanced disclosure on the liquidity of the fund's portfolio. The required liquidity risk management programs would have to classify the liquidity of each fund asset based on the amount of time in which the fund could convert that asset into cash without moving the

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[3] *Letter from Karen L. Barr, IAA CEO & President, to Financial Stability Board Re: Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions* (May 29, 2015), *available at* https://www.investmentadviser.org/eweb/docs/Publications_News/Comments_and_Statements/Current_Comments_Statements/150529cmnt.pdf.

[4] *See Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release*, SEC Release Nos. 33-9922; IC-31835 (Sep. 22, 2015), *available at* https://www.sec.gov/rules/proposed/2015/33-9922.pdf.

market price. The liquidity management program also would have to include a periodic assessment of the fund's liquidity risk and a determination of a "three-day liquid asset minimum"—a new concept that some amount, to be determined by each fund, must be invested in cash and assets that are convertible to cash within three business days. The program would be subject to board approval and annual review. The SEC has also proposed rules that would allow funds to use "swing pricing" once certain purchase or redemption thresholds were crossed.[5]

We believe that in proposing these rules on liquidity management, the SEC addresses the same concerns underlying Recommendations 1 - 5, 7 and 8. For example, the rules seek to reduce the likelihood of material liquidity mismatches; increase information, transparency, and reporting concerning funds' liquidity profiles; enhance investor disclosure requirements; improve the extent to which liquidity risk management tools are used and understood; and reduce first-mover advantage, specifically through the use of swing pricing.

Derivatives. The SEC has proposed to adopt a new rule under the U.S. Investment Company Act of 1940 to regulate the use of derivatives and the issuance of senior securities by registered open-end and closed-end investment companies, including ETFs, and business development companies.[6]

The rule would permit a fund to enter into derivatives transactions under the following circumstances: (1) it must comply with an overall portfolio limit on the amount of exposure to derivatives transactions and financial commitment transactions, measured at the time of each transaction (either a 150% limit on notional exposure without regard to hedging or cover transactions or a 300% limit on notional exposure using a value at risk ("VaR") test); (2) it must maintain an amount of "qualifying coverage assets" to cover the mark-to-market obligations under a derivatives transaction, as well as an "additional amount," determined by board-approved policies and procedures designed to address potential future losses and payment obligations under the derivatives transaction; and (3) except for a fund that uses a minimal amount of derivatives or does not use complex derivatives, it must establish a formalized derivatives risk management program administered by a designated derivatives risk manager who must be an employee or officer of the fund or adviser but may not be a portfolio manager of the fund. Other policies and procedures would generally be required, as well as recordkeeping and disclosure requirements. For example, funds would be subject to detailed recordkeeping requirements regarding the fund's portfolio limitations, notional exposure, VaR testing, and the coverage amount.

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[5] Swing pricing enables funds to adjust net asset value during heavy periods of redemptions or purchases, offsetting some of the costs associated with handling those flows. Although the IAA did not comment on this proposal, we note that many industry commenters expressed serious reservations about the feasibility of implementing swing pricing in the U.S. under the Investment Company Act.

[6] *See Use of Derivatives by Registered Investment Companies and Business Development Companies*, SEC Rel. Release No. IC-31933 (Dec. 11, 2015), *available at* https://www.sec.gov/rules/proposed/2015/ic-31933.pdf ("SEC Derivatives Proposal").

Enhanced Data Reporting. The SEC has adopted amendments to Form ADV (the registration and disclosure form for SEC-registered asset managers) to modernize and enhance data reporting to better assess and respond to risks across the asset management industry.[7] The amendments will require asset managers with large total separately managed account ("SMA") regulatory assets under management ("RAUM"),[8] and that manage accounts with large net asset values, to report more data to the SEC.

The amendments will require reporting of the following information: (i) for all asset managers, the amount of SMA RAUM invested in various asset categories; (ii) for asset managers with at least $500 million but less than $10 billion in separately managed account RAUM, the amount of aggregate SMA RAUM and the dollar amount of borrowings attributable to those assets that correspond to three levels of gross notional exposure as of the end of the year; and (iii) for asset managers with at least $10 billion in separately managed account RAUM, derivatives exposure across six derivatives categories.

The SEC has also proposed significant changes to reporting requirements for registered investment companies, such as mutual funds, including rule changes that would require standardized, enhanced disclosure about derivatives in investment company financial statements under the Investment Company Act of 1940.[9]

The SEC's enhancements to its collection of data on advisers and registered investment companies, in concert with its rules on liquidity management and derivatives, seek to address the same concerns underlying a number of the FSB's recommendations. These changes seek to increase the information available to the SEC, particularly on leverage and liquidity, which would in turn facilitate more meaningful monitoring and further enhance the SEC's understanding of leverage and liquidity risks in funds.

Business Continuity and Transition Planning. U.S. investment advisers, as fiduciaries, take protecting the interests of advisory clients very seriously, including by taking steps to address and mitigate the risks of business disruptions. Most SEC-registered investment advisers already have business continuity plans in place as part of their compliance policies and procedures and some have considered elements of transition planning as well.

To further enhance these practices, the SEC has proposed a new rule that would require all registered investment advisers to adopt and implement written business continuity

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[7] *See Form ADV and Investment Advisers Act Rules*, SEC Release No. IA-4509 (Aug. 25, 2016), *available at* https://www.sec.gov/rules/final/2016/ia-4509.pdf.

[8] RAUM is calculated on a gross basis, *i.e.*, without deduction of any outstanding indebtedness or other accrued but unpaid liabilities such as accrued fees, expenses, or the amount of any borrowing. *See* Form ADV: Instructions for Part 1A, instr. 5.b., *available at* https://www.sec.gov/about/forms/formadv-instructions.pdf.

[9] *See Investment Company Reporting Modernization*, SEC Release Nos. 33-9776; 34-75002; IC-31610 (May 20, 2015), *available at* http://www.sec.gov/rules/proposed/2015/33-9776.pdf.

and transition plans.[10] The proposed rule is designed to ensure that investment advisers plan and prepare in advance to address operational risks and preserve the continuity of advisory services in the event of a significant temporary or permanent business disruption in the adviser's ability to provide services to clients. The proposed rule covers both (i) business continuity after a significant business disruption (including disaster recovery planning such as when dealing with natural disasters, cyber attacks, technology failures, or the departure of key personnel), and (ii) business transition in the event an adviser is unable to continue providing advisory services to clients and ceases or winds down (*e.g.*, it exits the market, merges with another adviser, sells all or part of its business, or enters bankruptcy).

In proposing these rules, the SEC sought to address the same concerns underlying Recommendation 13, mainly the operational risk in transferring investment mandates or client accounts, including protecting client interests from being placed at risk as a result of the adviser's inability to provide advisory services.

Stress Testing. The SEC is considering appropriate ways to implement annual stress testing by large asset managers and large registered funds.[11] Although the SEC has not yet proposed these rules, the initiative is clearly based on the same concerns underlying Recommendations 6 and 9.

II. Leverage Within Investment Funds

The FSB expresses concerns that the "use of leverage by funds can create and/or amplify risks to the global financial system,"[12] and that current "metrics may not be ideal for measuring the potential impact of such leverage on financial stability."[13] It recommends that IOSCO

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[10] The SEC's proposed rule is available at https://www.sec.gov/rules/proposed/2016/ia-4439.pdf. The IAA's comment letter on the proposal is available at https://www.sec.gov/comments/s7-13-16/s71316-27.pdf.

[11] *See* Chair Mary Jo White, *Enhancing Risk Monitoring and Regulatory Safeguards for the Asset Management Industry* (Dec. 11, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370543677722, at note 27, citing Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, Section 165(i)(2), 124 Stat. 1423 (2010) (codified at 12 U.S.C. § 5365) ("The Dodd-Frank Act requires the Commission to establish methodologies for this stress testing of financial companies such as broker-dealers, registered investment companies and registered investment advisers with $10B or more in total consolidated assets—including baseline, adverse, and severely adverse scenarios—and to design a reporting regime for this stress testing, which must be reported to the Commission and the Federal Reserve Board.").

[12] Consultation at 23. The FSB states it is concerned with (i) funds that obtain leverage through borrowing or that use derivatives, resulting in "synthetic" leverage; and (ii) the potential for funds to transmit risk to their counterparties or through interconnections with investors and other intermediaries. The FSB states that it continues to remain concerned about: (i) the potential for funds to transmit risk to their counterparties or through interconnections with investors and other intermediaries, (ii) lack of consistent and accessible data on leverage that would facilitate aggregation of data and comparisons of different funds across jurisdictions, (iii) the absence of simple, uniform standards for measuring leverage, (iv) potential "contagion," and (v) leverage that may contribute to "procyclicality."

[13] Consultation at 24. The FSB states that most jurisdictions require investment funds to measure their leverage based on one or more metrics for compliance with regulatory leverage limits, reporting, or disclosure, including: (i) focusing on an investment fund's "on-balance sheet leverage," which is defined as the ratio of a fund's total on-

"develop simple and consistent measure(s) of leverage in funds" with due consideration for hedging and netting assumptions (Recommendation 10) and that IOSCO should collect national/regional aggregated data based on the measure(s) that it develops (Recommendation 12).

There are several concepts embedded in this Recommendation that we would generally support. For example, to the extent regulators pursue this type of undertaking, it ought to be led by local securities regulators through their participation in IOSCO's process. And broadly speaking, to the extent that asset managers have similar reporting obligations in multiple jurisdictions, we generally favor greater harmonization.

That said, however, we question whether IOSCO (or any global organization) could reach consensus on a single methodology to calculate leverage that would be appropriate for all types of funds in every jurisdiction around the world. In our view, IOSCO's time and energy would be better spent on a comprehensive survey that might lay the foundation for each local regulator to take steps appropriate to the funds in their jurisdiction, in accordance with the FSB's Recommendation 11.

A. No Universally Agreed-Upon Definitions or Measurements of Leverage

The primary barrier to achieving the type of global data collection envisioned by the FSB is that there is no universally agreed-upon definition of leverage in funds, much less any one agreed-upon way to measure it. Indeed, the FSB notes—and we agree—that various approaches to measuring leverage may be appropriate in light of the purposes and structure of the overall regulatory scheme for funds in a particular jurisdiction.

Our experience in the United States may provide a case study that demonstrates how difficult it would be to reach consensus. The SEC has considered various aspects of leverage separately in the context of private funds and registered funds, and the U.S. Financial Stability Oversight Council ("FSOC") has considered it more broadly.

The SEC does not require private funds to report "leverage," but does require them to report the gross notional value for derivatives (other than options) on Form PF[14] and to report a figure for "regulatory assets under management" that is meant to reflect some measure of the

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balance sheet assets to net asset value (NAV) (*i.e.*, the total balance sheet assets/NAV), or (ii) taking into account "synthetic leverage" that can arise from off-balance sheet transactions such as derivatives transactions by making assumptions about the extent to which netting and hedging effects should be recognized "in the calculation of leverage."

[14] We are not suggesting that the use of derivatives necessarily constitutes leverage. As discussed more below, it does not.

amount of leverage in the fund.[15] FSOC has found this insufficient. After analyzing Form PF data, FSOC noted that:

> These [PF] metrics are helpful for identifying potential areas for further analysis, but they are not sufficient to identify whether the use of leverage by hedge funds may present financial stability risks. In particular, aggregating notional derivative amounts to measure synthetic leverage is likely to overstate leverage. Evaluating risks from the use of leverage by hedge funds requires an analysis of other factors, which could include the nature of investment positions, trading and hedging strategies, financing arrangements, counterparties, margin requirements, and the effects of central clearing.[16]

Nonetheless, a few months later FSOC issued its annual report analyzing "leverage risk" in relation to financial stability considerations, which noted that Form PF showed that many hedge funds use relatively small amounts of leverage.[17] In reaching that conclusion, FSOC also noted that the "relationship between a hedge fund's level of leverage and risk, and whether that risk [might] have financial stability implications, is highly complex."[18] It cautioned that Form PF "does not provide complete information on the economics and corresponding risk exposures of hedge fund leverage or potential mitigants associated with reported leverage levels." FSOC has created a working group to further assess whether there are potential risks to financial stability in hedge fund activities and, in particular, consider potential enhancements or

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[15] Form PF is the Reporting Form for Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors, available at https://www.sec.gov/about/forms/formpf.pdf. *See* Question 13(b) of Form PF (provide the aggregate value of all derivatives positions of the reporting fund). *See also* https://www.sec.gov/rules/final/2011/ia-3308.pdf (adopting the new Form).

[16] *See FSOC Update on Review of Asset Management Products and Activities* at 15-16 (Apr. 18, 2016), *available at* https://www.treasury.gov/initiatives/fsoc/news/Documents/FSOC%20Update%20on%20Review%20of%20Asset%20Management%20Products%20and%20Activities.pdf. FSOC noted that it used a number of metrics for measuring leverage in hedge funds based on existing data from Form PF and expressed its view that each metric has certain shortcomings. FSOC used the following three metrics: (1) borrowing divided by net asset value (borrowing/NAV): this provides a measure of credit exposure relative to shareholder assets but does not measure synthetic leverage obtained through derivative investments; (2) gross asset value divided by net asset value (GAV/NAV): this provides a measure of financial leverage obtained through the use of cash borrowings (including repo, prime brokerage borrowing, and other secured and unsecured borrowing) but only includes the market value of derivatives and thus may understate synthetic leverage; and (3) gross notional exposure divided by net asset value (GNE/NAV): this provides the summed absolute values of long and short notional positions. This measure incorporates financial and synthetic leverage, but has limitations, including (i) the summing of long and short positions ignores favorable effects of hedging or offsetting positions, which may reduce risk, and (ii) it treats all notional derivative values equally when calculating leverage levels, so it does not capture differences in risk exposure across different classes of derivatives (however, notional exposure on Form PF is adjusted for certain derivative instruments; funds report delta-adjusted values for options and 10-year bond equivalent values for interest rate derivatives).

[17] *See* FSOC 2016 Annual Report at 10 (June 21, 2016) ("FSOC 2016 Annual Report"), *available at* https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/FSOC%202016%20Annual%20Report.pdf.

[18] FSOC 2016 Annual Report at 10.

"establishment of standards governing the current measurements of leverage, including risk-based measures of leverage."[19]

In the mutual fund context under the Investment Company Act, the SEC has evaluated "leverage" differently than in the private fund context for reporting on Form PF. The Investment Company Act does not define "leverage," but does restrict registered funds from investing in senior securities. Through that lens, leverage has been evaluated by the SEC for almost 40 years, with no specific definition, regulatory treatment, or adopted measurement of leverage articulated by the SEC.[20] For example, in discussing types of leverage as it relates to registered funds, the SEC has stated that "[c]ertain derivatives investments entered into by a fund, such as futures contracts, swaps, and written options, create obligations, or potential indebtedness, to someone other than the fund's shareholders, and enable the fund to participate in gains and losses on an amount that exceeds the fund's initial investment."[21] The SEC concluded that leverage created by such an arrangement is referred to as "indebtedness leverage."[22] Other derivatives entered into by a fund, such as purchased call options, provide the economic equivalent of leverage because they convey the right to a gain or loss on an amount in excess of the fund's investment but do not impose a payment obligation on the fund above its initial investment.[23] The SEC stated that this type of leverage is referred to as "economic leverage."[24]

These types of leverage may be obtained through a registered fund's "derivatives transactions and other senior securities transactions."[25] In analyzing how the Investment Company Act treats leverage, the SEC has noted that Section 18—which prohibits a registered fund from issuing senior securities—"limits a fund's ability to obtain 'leverage' or incur

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[19] FSOC 2016 Annual Report at 10.

[20] SEC Derivatives Proposal at 12 (quoting *Securities Trading Practices of Registered Investment Companies*, Investment Company Act Rel. No. 10666 (Apr. 18, 1979) [44 FR 25128 (Apr. 27, 1979)] ("SEC Release 10666")). The SEC noted in the SEC Derivatives Proposal that a "common characteristic of most derivatives is that they involve leverage or the potential for leverage." The SEC has stated that: "[l]everage exists when an investor achieves the right to a return on a capital base that exceeds the investment which he has personally contributed to the entity or instrument achieving a return." SEC Release 10666.

[21] *Use of Derivatives by Investment Companies under the Investment Company Act of 1940*, SEC Rel. IC-29776 ("SEC Concept Release") at 13, *available at* https://www.sec.gov/rules/concept/2011/ic-29776.pdf. The SEC proposed the term "derivatives transaction" in its SEC Derivatives Proposal to mean "any swap, security-based swap, futures contract, forward contract, option, any combination of the foregoing, or any similar instrument ("derivatives instrument") under which the fund is or may be required to make any payment or delivery of cash or other assets during the life of the instrument or at maturity or early termination, whether as a margin or settlement payment or otherwise."

[22] SEC Concept Release at 13 (citing *Mutual Funds and Derivative Instruments, Division of Investment Management Memorandum*, transmitted by Chairman Levitt to Representatives Markey and Fields (Sep. 26, 1994) ("1994 Report"), *available at* https://www.sec.gov/news/studies/deriv.txt)).

[23] SEC Concept Release at 13.

[24] SEC Concept Release at 13 (citing 1994 Report).

[25] SEC Derivatives Proposal.

obligations to persons other than the fund's common shareholders through the issuance of senior securities."[26]

Although there is no formal limit on leverage, the SEC stated its recent proposed rules on the use of derivatives in registered funds (discussed above) are designed to "impose a limit on the leverage a fund may obtain through the use of derivatives and financial commitment transactions and other senior securities transactions."[27] FSOC's reaction to this proposal shows that different approaches may be warranted in different contexts. It welcomed the SEC's efforts "to limit" the amount of "leverage" that these publicly offered funds may obtain through derivatives transactions by limiting the gross notional exposure ("GNE") of derivatives transactions in these mutual funds *while not trying to impose a same measurement or definition on registered funds as on private funds*.[28]

Other global regulators have also studied ways to measure leverage and reached different conclusions: the EU approach under UCITS using the commitment approach to limit leverage, where derivatives are included in the calculation; under AIFMD, the gross notional method or the commitment method is used, where derivatives are included in the calculation of leverage and enhanced disclosure is required; and under Basel III, the approach uses an estimate of risk-weighted exposure of each underlying derivatives exposure added to the gross assets of the portfolio, divided into the balance sheet total. There is no consensus that one reporting regime is superior to another.

We are concerned that any effort to develop a single reporting metric is likely only achievable if it resorts to the lowest common denominator, like the GNE of derivatives.[29] We strongly believe this would be a serious mistake both because it would be difficult and costly to

[26] See SEC Derivatives Proposal (defining "senior securities transaction" to mean "any derivatives transaction, financial commitment transaction, or any transaction involving a senior security entered into by the fund pursuant to [Sections 18 or 61] of the Act without regard to the exemption provided by" the proposed rule).

[27] SEC Derivatives Proposal at 9. The IAA has objected to the part of the SEC's proposal that would impose overall limits based on GNE. In our view, the Section 18 asset segregation regime effectively constrains leverage in registered funds without the need for overall exposure caps.

[28] *See supra*, note 4 (emphasis added). We do not necessarily agree that the use of derivatives transactions in registered investment companies creates "leverage" under Section 18 of the Investment Company Act, as the SEC has stated.

[29] We are discussing GNE only as an example of a relatively simple metric that might represent a "lowest common denominator" in this context. The FSB should recognize that global regulators, including in the U.S., have generally concluded that GNE does not adequately reflect the risk level or leverage. In fact, even the SEC noted in the final release for reporting by investment advisers' separate account assets that that GNE is "not a risk measure" and does "not always reflect the way in which derivatives are used in a [SMA]" but rather are commonly used metrics that are comparable to information collected in Form PF regarding private funds. SEC Form ADV and Investment Advisers Act Rules, *supra*, note 7. The SEC's view is that GNE is appropriate to collect information on the "scale" of an SMA's derivatives activities, "rather than to collect specific risk metrics or more granular information regarding the ways in which derivatives are used in a separate account." *Id*. at 105. Although the SEC's rules for Form ADV do not address reporting "leverage" for investment funds, the final rules and SEC statements highlight the absence of an easy way to measure leverage.

report and, more importantly, it would not provide regulators with meaningful information. GNE—proposed by the SEC for registered funds—is simply not sufficient to provide reliable information about an investment fund or to draw conclusions about the impact of one fund, or many funds, on financial stability. As we said to the SEC in our comment letter on the SEC Derivatives Proposal, "gross notional exposure from derivatives transactions is an inapt way to measure leverage and risk" and should not be used for the SEC's proposed portfolio limits for registered investment funds.[30] In order to be meaningful, firms must be permitted to adjust gross notional exposures to take into account various factors that reduce or better reflect risk, such as netting agreements that close out positions, hedging, adjustments to reflect duration, or whether or not the derivatives are centrally cleared.[31] These types of adjustments would make the reported data more meaningful, but also far more complex. It may be appropriate in the context of the SEC's particular rule on derivatives used by registered funds, but would be unlikely to be universally accepted for all types of funds in all jurisdictions.

For all these reasons, we believe the FSB should reconsider its Recommendation 10 to develop one simple and consistent measure of leverage in funds. Such an undertaking is complex, and even within a single jurisdiction, such as the U.S., thoughtful analyses over years has not resulted in a single and consistent measure of leverage within the registered fund context or the private fund context. Even after appropriate consideration and analysis of factors, an attempt at such an undertaking may result in different reporting regimes for various types of funds. Getting to a single worldwide metric would be exponentially more difficult.

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[30] *See Letter from Robert Grohowski, General Counsel, IAA to the SEC re: Use of Derivatives by Registered Investment Companies and Business Development Companies* ("BDCs") (Mar. 28, 2016), *available at* https://www.investmentadviser.org/eweb/docs/Publications_News/Comments_and_Statements/Current_Comments_Statements/160328cmnt.pdf. *See also Supplemental Letter from Robert Grohowski, General Counsel, IAA to SEC re: Use of Derivatives by Registered Investment Companies and BDCs* (Aug. 18, 2016), *available at* https://www.investmentadviser.org/eweb/docs/Publications_News/Comments_and_Statements/Current_Comments_Statements/160818cmnt.pdf (supporting ICI's supplemental letter to SEC re: Derivatives Use by Registered Investment Companies and BDCs (July 28, 2016), *available at* https://www.sec.gov/comments/s7-24-15/s72415-244.pdf).

[31] *See Letter to the SEC from Robert Grohowski, General Counsel, IAA re: Amendments to Form ADV and Investment Advisers Act Rules* (Aug. 11, 2015); *see also FSB/IOSCO Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions* (Mar. 4, 2015) at 39, n.60, *available at* http://www.financialstabilityboard.org/wp-content/uploads/2nd-Con-Doc-on-NBNI-G-SIFI-methodologies.pdf (in discussing gross notional exposure for investment funds, noting "the calculation of the global exposure as defined in EU regulation through the so-called 'commitment approach' allows adjustment of GNEs based on clearly-defined hedging and netting rules"). *See also Letter from PIMCO to FSB/IOSCO on Second Consultation* (May 29, 2015), *available at* http://www.financialstabilityboard.org/wp-content/uploads/PIMCO.pdf; *Letter from AIMA to FSB/IOSCO re: Response to the second FSB and IOSCO Consultation Paper on Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions* (June 1, 2015) at 8, 12, *available at* http://www.financialstabilityboard.org/wp-content/uploads/Alternative-Investment-Management-Association-AIMA.pdf (noting that "GNE does not directly represent an amount of money (or value) that is at risk. It is a reference figure used to calculate profits and losses.").

B. *Benefits of an IOSCO Survey*

The experience in the United States demonstrates how difficult it would be to develop a single metric to measure leverage. IOSCO's time would be far better spent developing a survey on global leverage measurements/reporting. Such a survey could begin to evaluate (i) different definitions of "leverage" used among jurisdictions and within jurisdictions based on different types of funds; (ii) whether jurisdictions limit an exposure based on the type or purchaser of a particular fund; and (iii) the rationale for the different treatment among jurisdictions. After such a review, more meaningful conclusions could be made and effective actions could be taken.

For all these reasons, we believe the FSB should reevaluate Recommendations 10 and 12 and refrain from recommending that IOSCO develop a single, global measure of leverage in all types of investment funds.

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We appreciate the opportunity to provide comments on the Consultation and would be pleased to provide any additional information. Please contact the undersigned, Monique Botkin, Associate General Counsel, or Laura Grossman, Assistant General Counsel, at (202) 293-4222 with any questions regarding these matters.

Respectfully submitted,

Robert C. Grohowski
General Counsel