September 21, 2016

Mr. Svein Andresen  
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 dated June 22, 2016

Dear Mr. Andresen:

The Institute of International Finance (IIF, The Institute) is pleased to provide comments on the Financial Stability Board (FSB) Consultative Document “Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities” of June 22, 2016. This letter has been produced under the guidance of the IIF’s Non-Bank Non-Insurer Working Group. In offering these comments, we believe it is important to reiterate the industry’s support for targeted and proportionate measures designed to address potential systemic risks and thus make the global financial system more stable and better able to facilitate economic growth.

The IIF fully recognizes the importance of the FSB’s work (in cooperation with other agencies) on identifying sources of systemic risk. This is a very challenging task which, if done correctly, can reinforce financial stability but if not, could have unintended detrimental consequences on financial markets, those they serve in the broader economy, and on economic growth. In this context we encourage the FSB to extend their analysis to potential consequences of the exceptionally accommodative monetary policy in many countries. On the one hand, extraordinarily low interest rates have triggered strong credit and asset price increases and raised concerns about the built-up of concomitant vulnerabilities. One the other hand, ‘quantitative easing’ has turned central banks into dominant actors within certain asset classes and has caused severe distortions in market prices and risk premiums. While the positive implications of these policies on economic growth are increasingly called into question potential repercussions on financial stability remain widely unexplored.

Against this background, the Institute appreciates the continued openness of the FSB and relevant agencies to consult and engage with the industry and to hear our perspectives and those of other stakeholders, in particular on the important subject of asset management activities.

Key Considerations:

- We believe that the application of targeted regulation to properly defined and identified risks on an activity- or industry-wide basis is the most appropriate response to systemic risks. Against this backdrop we commend the FSB for focusing their analysis and their policy recommendations on certain activities. However, any such regulation should not be limited to the relevant industry in a narrow sense but include all capital markets participants that might offer a given product or engage in a given activity.

- We strongly believe that in the context of the asset management sector the only relevant transmission channel for potential global systemic risk is the exposure (counterparty) channel via leverage in investment funds. This is where attention should be focused.

- We do not believe that open-ended funds in general are facing material mismatches between liquidity of fund investments and daily redemptions of fund units let alone mismatches that can plausibly give rise to an impairment of all or parts of the financial system. Historic events were limited to specific asset classes, could be managed with the existing liquidity management tools and were far from igniting a systemic crisis.

- From the industry’s perspective, undifferentiated across the board stress-testing is not appropriate. The scope of any stress testing requirements and the calibration of the stress test assumptions should recognize differences among funds, existing regulatory requirements, shareholder demographics and historical behavior. Further, we are very skeptical about the merits of ‘macro’ or ‘system-wide’ stress-testing.

- There is no evidence of a threat to financial stability from the resolution of investment funds and their advisers but significant evidence demonstrating that their resolution does not threaten financial stability. Any market impact is alleviated by the fact that in order to replace an asset manager—for whatever reason—assets would not have to be moved physically since they are being held by a custodian. If an asset manager goes out of business or an investor decides to substitute an asset manager the assets can remain with the same custodian in a client denominated account.

- Borrower default indemnification is only triggered if the counterparty to a securities loan defaults and the collateral is insufficient to cover the cost of replacing the securities. To our knowledge such claims are extremely rare. We are not aware that securities loans indemnifications have ever been triggered to any sizeable extent. Given the limited potential losses associated with borrower default indemnification due to overcollateralization and daily mark-to-market practices, there is no systemic risk associated with this practice.

- We welcome any initiative to address data gaps relating to funds. In conducting this task, we appreciate the willingness to take existing data gathering as well as proportionality into consideration. The envisaged review should not only extend to existing obligations but also cover those already under consideration. We also encourage the FSB and IOSCO to play a stronger role in facilitating international information sharing among regulators and supervisors.

- We are convinced that in order to regulate markets effectively reasonable policies have to be applied broadly irrespective of size, nature and legal setting of the individual entity. We are also convinced that application of such policies will further strengthen our argument that entity-based searches for systemic risk in the asset management sector are heading into the wrong direction. Accordingly, the pursuit of a NBNI G-SIFI assessment methodology should be abandoned.
In general, a focus on activities is the right approach

The IIF has consistently drawn attention to the shortcomings of attempts to identify and regulate systemic risk that rely on designating individual entities and applying additional policy measures to these entities on a blanket basis. Instead, the IIF has argued that policy should focus primarily on the underlying activities involved and on analyzing any associated risks, should be sufficiently forward looking, and should take into account the quantity, variety and complexity of activities and participants in the markets. In general, we believe that the application of targeted regulation to properly defined and identified risks on an activity- or industry-wide basis is the most appropriate response to systemic risks. Such regulation however should not be limited to the relevant industry in a narrow sense but include all capital markets participants that might offer a given product or engage in a given activity. Against this backdrop we commend the FSB in principle for focusing their analysis and their policy recommendations on certain activities.

Nevertheless, we are concerned about the narrow focus on managed assets rather than all asset owners in a given market and the failure to offer empirical evidence of “residual risks to the global financial system that warrant policy responses.” In the absence of empirical evidence we have to comment on hypothetical presumptions of residual risks in asset management activities and on corresponding policy proposals. We question that this is an adequate foundation for sound policymaking. As leading academics have observed, to identify and regulate systemic risk, regulators must be able to define and measure it, not merely speculate about it.²

The difficulty in engaging in a constructive dialogue is compounded by the lack to provide exact definitions of key elements within the Consultative Document. Macro-economic terms that are essential to understanding and applying the policy recommendations—starting with ‘financial stability’, ‘financial stability risks’ and ‘structural vulnerability’ but also extending to terms like ‘stressed market conditions,’ and ‘first mover advantage,’—are unnecessarily opaque. In particular, market conditions that may trigger the application of extraordinary policy measures require definitions, modeling and measurement. We are concerned about leaving things vague and potentially following a ‘know it when you see it’-approach which will by necessity lead to a substantial amount of regulatory discretion. This, in turn, may not only lead to a temptation to respond to political pressures but also make measurement of policy effects and evaluation of policy alternatives all the more challenging.³

In its Consultative Document the FSB describes four aspects of asset management that they label ‘structural vulnerabilities’ and deem to pose potential risks to financial stability: liquidity mismatches, leverage, operational risk in transferring investment mandates in stressed conditions; and securities lending activities.

The FSB, the International Monetary Fund (IMF) and the Bank for International Settlements (BIS) have defined “systemic risk as a risk of disruption to financial services that is (i) caused by an impairment of all or parts of the financial system and (ii) has the potential to have serious negative consequences for the real economy. Fundamental to the definition is the notion of negative externalities from a disruption or failure in a financial institution, market or instrument.”⁴ This is a high standard which is not clearly met by the FSB’s analysis. In our view, in order for a risk to merit policy action, the FSB must prove that: (i) ‘structural vulnerabilities’ (however defined) exist, (ii) could threaten the global financial system,

³ Id.
(iii) are not sufficiently mitigated by existing regulation, economic incentives or natural constraints, (iv) cannot be sufficiently mitigated by enhancement of existing regulation, and (v) the policy recommendations would effectively reduce the real and identifiable risk without creating unintended costs that outweigh the benefits.

In our view the FSB fails to demonstrate that most of these vulnerabilities exist in the first place. Indeed, the International Organization of Securities Commissions (IOSCO) in a recent report could not identify “evidence of contagion or systemic events following fund liquidity stress events outside the money market fund space.”\(^5\) In the Consultative Document, the FSB typically concludes the existence of a ‘structural weakness’ by exposing a certain factual observation (e.g. “increased investment in particular asset classes”) to a set of unproven or even wrong assumptions. The excessive use of words like ‘may’ or ‘could’ is disturbing in this context. Furthermore, the FSB fails to establish the link between the perceived ‘structural vulnerability’ on the level of the individual fund or asset manager and global financial stability that would be necessary to justify many of their policy recommendations.

In our view, a mechanistic aggregation of the impacts of alleged structural weaknesses on the level of an individual fund or manager is by no means appropriate to identify systemic risks at the global level. Such an approach completely ignores not only the heterogeneity of funds and their investors but in particular the small percentage of financial assets that are managed by third-party asset managers, the smaller percentage held in collective investment funds, and the potential market dynamics created by heterogeneous asset owners and potential buyers of those assets during hypothetical stress market events. Further, the FSB fails to recognize the effectiveness of the comprehensive regulatory framework under which investment funds operate in major jurisdictions as well as financial reforms implemented in the aftermath of the financial crisis which were specifically aimed at reducing risks in the global financial system. Finally, the FSB does not even try to quantify benefits and to identify potential negative repercussions of its policy recommendations and to weigh these effects as part of a sound cost-benefit analysis.

**Leverage**

Recent research has demonstrated that the risks of a financial crisis rise substantially and the ensuing recessions are considerably more painful if asset price bubbles interact with a credit boom.\(^6\) These observations are in line with the position we have taken in our earlier submissions: We strongly believe that in the context of the asset management sector the only relevant transmission channel for potential global systemic risk is the exposure (counterparty) channel via leverage in investment funds. This is where attention should be focused. Against this backdrop, we commend the FSB for developing policy recommendations aimed at measuring and monitoring the use of leverage by investment funds.

Indeed, some investment funds may employ leverage on behalf of their clients as part of the investment strategy of a particular investment fund or product. Asset management clients benefit from the potential upside provided by leverage, and similarly bear the risk of any increased asset price volatility. Regulatory standards require that these risks are disclosed to investors. However, even the funds with the highest leverage operate with much lower leverage ratios than other entities in the financial sector (in particular

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banks for which leverage is an inherent aspect of their business models). We agree with the FSB that “most open-ended funds have been generally resilient. They have not created financial stability concerns in recent periods of stress and heightened volatility.”

Furthermore—and not at least due to the experiences gathered in the Long Term Capital Management (LTCM) crisis in 1998 as correctly mentioned by the FSB—the use of leverage in a number of investment products is now subject to extensive regulation. While private funds in the United States (U.S.) are generally not subject to regulatory leverage restrictions, many agree to abide by leverage limits in their offering materials and provide transparency to investors regarding current leverage levels. Registered mutual funds in the U.S. are subject to extensive regulation with regard to their use of leverage that includes limits on borrowing and requirements to hold sufficient assets to cover derivatives exposures. Further, the U.S. Securities and Exchange Commission (SEC) recently issued a proposal for comment that, if implemented, would further limit the use of derivatives by U.S. registered funds. In the European Union (EU) regulatory regimes under both the UCITS (Undertakings for Collective Investment in Transferable Securities) Directive and the AIFMD (Alternative Investment Fund Managers Directive) also ensure that more highly leveraged activities require additional regulatory constraints or are capped.

Beyond balance sheet leverage many investment funds may make use of financial derivatives transactions, which can result in the creation of synthetic leverage. However, regulatory and market changes implemented since 2008 have significantly reduced the risk associated with those activities. Central clearing, netting of risk positions, mandated changes to documentation and collateral practices, increased dealer requirements and other changes have significantly reduced counterparty risk, fundamentally changed trading practices, improved dealer risk management and therefore mitigated the potential risk to individual counterparties and to the financial system as a whole.

Finally, in considering leverage and the potential impacts of leverage on the markets, it is important to understand that leverage can occur not only at the product level, but also at the end-investor’s portfolio level. Importantly, the use of leverage is not limited to assets managed by investment funds. As we saw in the 2008 financial crisis, many wholesale and retail investors who had employed leverage on their own balance sheets were forced to liquidate investments to meet their individual liquidity needs and margin calls. Therefore, if existing regulation and reforms are found wanting to manage the risk of leverage in the global financial system, even after implementing comprehensive reforms to markets and market participants since the crisis, then any necessary additional reforms should be focused on the activity in general and not be limited to the asset management industry. We concur with IOSCO that “it is important to take a holistic approach to the markets, considering all actors and the substantial changes in the market envi-

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7 As recently observed in a report of staff members of the European Central Bank: “Compared to the traditional banking sector where assets are often more than 10-30 times the size of equity, leverage in the investment fund sector is low with total assets much less than twice the amount of equity.”; Doyle, Nicola/Hermans, Lieven/Molitor, Philippe/Weistroffer, Christian, Shadow banking in the euro area: risks and vulnerabilities in the investment fund sector, European Central Bank Occasional Paper Series, No 174, June 2016, p. 26 (https://www.ecb.europa.eu/pub/pdf/scpops/ecbop174.en.pdf).
8 See Section 18(a)(1)(A) of the Investment Company Act of 1940 (15 U.S.C. § 80a-18(a)(1)(A)): Open end funds cannot borrow more than 33.3% of total assets. The SEC interprets Section 18 of the Investment Company Act to say that a fund can avoid the creation of a ‘senior security’ under Section 18 by segregating ‘liquid’ assets to cover its payment obligations under such instruments or otherwise cover its obligations under such instruments, these rules are commonly referred to as asset segregation rules.
10 For further details see Doyle/Hermans/Molitor/Weistroffer, supra (note 7), pp. 27-28.
Liquidity mismatches

We do not believe that open-ended funds in general are facing material mismatches between liquidity of fund investments and daily redemptions of fund units let alone mismatches that can plausibly give rise to an impairment of all or parts of the financial system and have the potential to have serious negative consequences for the real economy. Implicitly, the FSB is translating structural vulnerabilities of banks to the asset management sector without properly recognizing the differences in the business models. A ‘first-mover advantage’ is characteristic for the depositor in a bank and is the textbook example of a prisoner’s dilemma that can indeed lead to a run on a certain bank and develop into a systemic crisis. The problem originates in the balance sheet of a bank: On the liability side a bank promises to repay the full amount of a customer’s deposit on demand whereas many assets, such as mortgage loans, are illiquid, and hard to value as they depend on appraisals. Against the backdrop of this maturity and liquidity transformation a bank is typically unable to repay all its depositors at the same time and on short notice. If a deterioration in the quality of its assets raises concerns with regards to the solvency of a bank it is rational for each depositor to ‘run’ on the bank to withdraw his or her deposit and to leave the other depositors with worthless or at least illiquid claims once the bank’s cash funds run out. This dilemma is in fact one of the main reasons for the establishment of deposit guarantee schemes in many jurisdictions.

In our view, the proposal ignores the fact that investment funds do not show similar vulnerabilities. As we will explain in more detail below, most assets are liquid and marked-to-market. In the case of less liquid assets funds have liquidity management tools at their disposal to cope with increased redemption requests. Consequently, over the past decade supervisors reported only very few incidents of open-ended funds having insufficient capacity to meet redemptions. While in these rare cases liquidity management tools were activated in order to ensure protection of investors and the impacts of such actions have been acutely felt by fund investors, IOSCO has concluded that “the broader, system wide consequences of invoking such tools have been limited.” Against this backdrop, the limited historic events cannot serve as a rationale to curtail the operations of all open-ended funds.

Open-ended investment funds with a focus on listed securities (equity, fixed income) and a variable Net Asset Value (NAV) typically do not show the vulnerabilities mentioned in the Consultative Document. On the asset side of the balance sheet, a fund’s assets are liquid, marked to market or fair valued daily, and publicly disclosed regularly. On the liability side of the balance sheet, the repayment obligation of an investment fund is derived from the aggregate value of the assets. A fund promises to repay only the current value of a shareholder’s investment, based on the fund’s NAV next determined after the redemption request is made (typically as of the close of trading). That current value at which the shareholder must be redeemed is based on the daily value of the fund’s portfolio assets. These two features—the absence of a fixed repayment obligation competing for a limited amount of assets, combined with market/fair value pricing—effectively eliminate the conditions necessary for a ’first-mover advantage’. Thus, a precondition for a crisis that could lead to a ‘run’ on a complete asset class is a fixed repayment obligation competing for a limited amount of assets or a flawed pricing mechanism.

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11 IOSCO, supra (note 5), p. 81.
12 See the definition provided by FSB/IMF/BIS, supra (note 3).
13 See IOSCO, supra (note 5), p. 80.
As an example for the former IOSCO mentions real estate funds in Australia, the Netherlands, and Spain that faced liquidity problems during periods of high redemptions. However, problems with meeting increased redemption requests were successfully addressed by applying existing liquidity management tools in coordination with the supervising authorities. After redemptions were finally suspended “(t)here was no sign of spillovers or any other symptoms that could indicate systemic risk.” A similar observation could recently be made in the United Kingdom (UK): Six of the UK’s largest real estate funds had to freeze almost £14.6 billion of assets after Britain’s vote to leave the EU caused an increased level of redemptions from UK property funds. As a result, more than half of the £25 billion of funds committed to commercial real estate by retail investors had used tools at their discretion to ensure all shareholders were treated fairly. Interestingly, several funds used different tools including implementing suspensions or redemption fees. While this is another example for a market event that triggered limited problems in a specific asset class it demonstrates that the problems in these funds could be managed with the existing tools and were far from igniting a systemic crisis – not even on a national scale.

Stress testing could potentially be a useful tool to inform asset managers and supervisors of the repercussions of a stressed market conditions and the ability of an open-ended fund to meet redemption requests of its investors in certain limited circumstances where there is empirical evidence of a potential inability to meet such requests in a timely manner. However, from the industry’s perspective, undifferentiated across the board stress-testing is not appropriate. The scope of any stress testing requirements and the calibration of the stress test assumptions should recognize differences among funds, existing regulatory requirements, shareholder demographics and historical behavior. Furthermore, it should be recognized that fund liquidity is less relevant for funds that have a variety of liquidity risk management tools available, such as the ability to meet redemption requests in part or completely by transferring assets in-kind, to introduce swing pricing, impose redemption fees or suspend redemptions.

While we recognize that stress testing may be useful on the level of the certain individual funds we are very skeptical about the merits of ‘macro’ or ‘system-wide’ stress-testing. Funds only represent a small portion of a diverse global marketplace and data is not available on many other market participants. The effectiveness of performing a system-wide stress test without data that is representative of the entire system would be highly questionable. We agree with IOSCO that only a holistic approach to the market that involves all relevant actors will lead to meaningful results.

We conclude that any policy recommendation should not extend to open-ended funds in general but should be tailored to specific asset classes that may be more or less liquid. Indeed, as IOSCO has recently observed, “(m)any liquidity management tools are available to jurisdictions, some of which are specifically tailored to the features and nature of the funds considered (e.g., money market funds, real estate funds, hedge funds).”

Operational risk and challenges in transferring investment mandates or client accounts

This section of the Consultative Document makes a series of assertions, which are neither based on facts nor is there any evidence to suggest that the hypothetical scenarios described could potentially create sys-

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15 IOSCO, supra (note 5), p. 80.
18 See IOSCO, supra (note 5), p. 81.
19 IOSCO, supra (note 14), p. iii.
temic risk in a real stress market situation. In fact, as the FSB and IOSCO (in their first NBNI G-SIFI consultation) and the U.S. Financial Stability Oversight Council (FSOC) have acknowledged, there is no evidence of a threat to financial stability from the resolution of investment funds and their advisers but significant evidence demonstrating that their resolution does not threaten financial stability. This is corroborated by the following observations:

Unlike other types of financial institutions, asset managers do not require resolution. Asset manager business models are based on the generation of revenue through investment management fees earned for managing client assets. In the event that clients become dissatisfied with a manager’s performance or a reputational issue occurs, clients may choose to terminate the manager and select a new manager to manage their assets. Unlike in the case of banks, where reputational issues can lead to a loss of funding for daily operations causing the bank to fail very rapidly, reputational issues for asset managers lead to a loss of revenue. While revenue declines eventually can put a manager out of business, such situations do not arise overnight. Insolvency is even less likely to occur as a result of operational risk, which is typically idiosyncratic, fixable, and insured. Further, client assets are not on asset manager balance sheets and are, therefore, not entangled in bankruptcy proceedings that would require resolution.

As the FSB has acknowledged any impact of an asset manager going out of business is very limited as entities in the asset management sector are highly substitutable. We agree with the FSOC that “clients have routinely replaced asset managers without significant impact in non-stressed situations.” The data show that the same is true in stressed markets. Any market impact is alleviated by the fact that in order to replace an asset manager—for whatever reason—assets would not have to be moved physically since they are being held by a custodian. If an asset manager goes out of business or an investor decides to substitute an asset manager the assets can remain with the same custodian in a client denominated account. In no case will the assets become subject to asset liquidation. Against this backdrop, we do not share the FSB’s concerns “transferring investment mandates (or client accounts) between asset managers can give rise to a series of operational challenges” that would generate or transmit systemic risk. We note that managers and other service providers are highly substitutable and already process a high volume of asset transfers daily. Neither the financial crisis nor any more recent stress market scenarios have exposed weaknesses in these processes that threatened financial stability.

Securities lending activities

In general, most investment funds engage in securities lending only to a very limited extent. The various securities lending programs do not create material investment risk to the single fund let alone can they be the ultimate source of risk to global financial stability. Typically, borrowers are required to post collateral between 102% and 112% of the value of the securities lent and the value of the collateral and the securities loaned are marked-to-market daily, with additional collateral posted when necessary. In case of non-cash collateral the pledged securities are held by a third-party custodian and are not available for re-hypothecation. If cash is pledged as collateral the funds are typically invested in a Money Market Fund (MMF) or other cash vehicles with very similar portfolio constraints. Post-crisis the regulation of cash

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21 “In other words, the investment fund industry is highly competitive with numerous substitutes existing for most investment fund strategies”; FSB/IOSCO, supra (note 20), p. 30.
22 FSOC, supra (note 20), p. 77493.
vehicles has been substantially overhauled in multiple jurisdictions resulting in very conservative guidelines for these vehicles.

Against the backdrop of established industry practice we regard it as practically impossible that a fund might be forced to execute fire sales of assets in order to return cash collateral received for securities loans. We also would like to remind the FSB that cash-collateralized securities lending is already recognized by the FSB’s framework for haircuts on non-centrally cleared securities financing transactions.23

Some asset managers act as lending agents for their customers by arranging securities loans between lenders and borrowers. Over the past two decades it has become the practice of lending agents to offer to some lenders indemnification against ‘borrower default’—i.e., the borrower failing to return the securities that have been lent. This indemnification, however, is limited to the ‘shortfall’ that could occur in the event the collateral delivered is insufficient to acquire replacement securities for those out on loan. Thus, borrower default indemnification is only triggered if the counterparty defaults and the collateral is insufficient to cover the cost of replacing the securities. To our knowledge such claims are extremely rare. We are not aware that securities loans indemnifications have ever been triggered to any sizeable extent—not even in the recent financial crisis. Given the limited potential losses associated with borrower default indemnification due to overcollateralization and daily mark-to-market practices, there is no systemic risk associated with this practice.

Whereas regulatory capital in banks is designed to ensure resilience and this capital can be used by the bank for multiple purposes, it is not held solely to cover potential losses associated with borrower default indemnification. In contrast, non-bank agent lenders generally have financial resources in the form of unencumbered liquidity or reinsurance that are dedicated to covering potential borrower default indemnification exposure, as the ability to make good on an agreement with one’s clients is generally a prerequisite for a client entering such an agreement. As such, there is no basis for the FSB’s assertions about regulatory arbitrage in this space. Efforts to mitigate potential risks associated with securities lending would be better spent reviewing risk management practices of all agent lenders, including the guidelines for cash reinvestment vehicles to ensure they have been updated in line with post-crisis regulatory standards.

Data Gaps

We agree with IOSCO that the understanding of the fund industry can and has to be enhanced. In particular, we join IOSCO in recognizing a need for further empirical analyses, the identification of data gaps as well as the identification of testable hypotheses to generate much needed quantitative estimates of potential impacts.24 Against this backdrop, we welcome IOSCO’s recent initiative to address data gaps relating to funds.25 The IIF has consistently advocated for sound and data-based regulation. Without sufficient data and interpreting analytics any policy measure is likely to do more harm than good. However, efforts to collect data to study potential risks to the financial system from an activity need to endeavor to collect data from all participants conducting that activity in order for such efforts to provide meaningful information. Focusing on only the small subset of market participants where regulation requires public transparency will lead to conclusions that are not in line with the realities of a diverse marketplace.

24 See IOSCO, supra (note 5), p. 10.
In conducting this task, we appreciate the willingness to take existing data gathering as well as proportionality into consideration. Before requesting the collection of additional data it has to be ensured that regulators and supervisors make use of and verify the usefulness of all the data that are already being collected. In light of increasing reporting and disclosure requirements across the board the administrative burden of every new obligation should be limited as far as possible. This does not only imply to recognize existing obligations but also those that are already under consideration. For example, in the United States the SEC recently finalized enhanced reporting rules for advisers and proposed new rules and forms to modernize and enhance data reporting and disclosure for funds. While the industry is generally supportive of this initiative concerns with regards to specific details of the proposal have been described in various comment letters. We note that a special focus is given to the reporting and disclosure of investments in derivatives, the liquidity and valuation of holdings, and securities lending practices. Assuming proper refinement of the proposal, upon availability, all this data will provide supervisors, policy makers and the general public with additional and very helpful insights.

We also encourage the FSB and IOSCO to play a stronger role in facilitating international information sharing among regulators and supervisors. As a matter of fact, much of the data that is already being collected is not being shared among various agencies and across jurisdictions. In this context we urge supervisors to make better use of the Multilateral Memorandum of Understanding. The industry is concerned about a lack in cooperation that leads to multiple requests from different sources and in different formats for the same data and leads to an unnecessary administrative burden. Regulators need to be more mindful of the cumulative impact of these requests, as ultimately the cost of data collection and production are borne by investors.

Scope of the analysis

It has to be recognized that public financial institutions, sovereign wealth funds (SWFs) and pension funds are significant players in the global financial markets. They contribute to the roughly 75% of the world’s financial assets not managed by third-party asset managers but by the asset owner directly. Against this backdrop they have to be included in any thorough market analysis and policy making.

While we agree with the FSB that certain types of pension funds and SWFs may potentially pose financial stability risks we do not concur that these risks “vary by size, nature, and legal settings of the individual entity”. As we have explained in our earlier submissions ‘size’ is not necessarily correlated to systemic risk. Specifically in the context of asset management, the volume of assets under management (AUM) provides limited insight, as the asset mix could be invested in many different ways and present a vast spectrum of ’riskiness‘ into which size provides no meaningful insight. Thus, any policy that simply connects to size is to some extent arbitrary.

Against this background we support the FSB in encouraging the relevant authorities to refer to the proposed recommendations in the Consultative Document in considering their policies towards pension funds and SWFs in their jurisdictions. We are convinced that in order to regulate markets effectively reasonable policies have to applied broadly irrespective of ‘size, nature and legal setting of the individual


entity’. We are also convinced that application of such policies will further strengthen our argument that entity-based searches for systemic risk in the asset management sector are heading into the wrong direction. Accordingly, the pursuit of a NBNI G-SIFI assessment methodology should be abandoned.

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In addition to the general comments presented above, the Institute would like to offer the following answers to the specific questions raised in the Consultative Document:

**Q1. Does this consultative document adequately identify the structural vulnerabilities associated with asset management activities that may pose risks to financial stability? Are there additional structural vulnerabilities associated with asset management activities that the FSB should address? If there are any, please identify them, as well as any potential recommendations for the FSB’s consideration.**

In our view history leads to the conclusion that the potential for systemic risk may rather be embedded in the failure of a certain asset class or a specific business model than in the operations of a single firm.\(^{28}\) However, where a single firm has caused systemic disruption it generally results from highly leveraged operations which have accumulated significant under-protected exposures or have caused disruption through their lack of substitutability.

We strongly believe that in the context of the asset management sector the only relevant transmission channel for potential global systemic risk is the exposure (counterparty) channel via leverage in investment funds. This is where attention should be focused. Compared with leverage liquidity mismatches are only of minor importance. As we will explain in more detail below (see answer to Q4) liquidity mismatches require a fixed repayment obligation competing for a limited amount of assets to become relevant. However, existing liquidity risk management practices as well as regulatory tools provide an effective remedy to deal with extraordinary redemption requests. As IOSCO has concluded, there is no evidence that liquidity mismatches in certain funds, liquidity challenges in these funds or any remedial action taken by fund managers or supervisors have ever had systemic consequences.\(^{29}\)

Finally, we do not think that operational risk and challenges in transferring investment mandates or client accounts or securities lending activities of asset managers and funds can lead to systemic risks. This stance is corroborated by a recent study provided by staff of the European Central Bank. An analysis of risks and vulnerabilities in the investment fund sector mentions liquidity transformation and leverage but does not recognize operational risks and securities lending activities.\(^{30}\)


\(^{29}\) See IOSCO, supra (note 5), p. 75, p. 81.

\(^{30}\) See Doyle/Hermans/Molitor /Weistroffer, supra (note 7).
Q2. Do the proposed policy recommendations in the document adequately address the structural vulnerabilities identified? Are there alternative or additional approaches to risk mitigation (including existing regulatory or other mitigants) that the FSB should consider to address financial stability risks from structural vulnerabilities associated with asset management activities? If so, please describe them and explain how they address the risks. Are they likely to be adequate in stressed market conditions and, if so, how?

We are concerned that key terms of this question, i.e. ‘financial stability risks’ and ‘structural vulnerabilities’, are not defined in the Consultative Document and thus unnecessarily opaque. In general, key macroeconomic terms have not been defined in the Consultative Document. In particular, market conditions that may trigger the application of extraordinary policy measures require definitions, modeling and measurement. We are concerned that assuming the existence of risks without substantiating them and leaving the design and application of new policies overly vague invites a ‘know it when you see it’-approach which will by necessity lead to a substantial amount of regulatory discretion and create uncertainty for investors and other market participants.

Below we provide comments on the specific recommendations provided by the FSB:

Recommendation 1: Authorities should collect information on the liquidity profile of open-ended funds in their jurisdiction proportionate to the risks they may pose from a financial stability perspective. They should review existing reporting requirements and enhance them as appropriate to ensure that they are adequate, and that required reporting is sufficiently granular and frequent.

We welcome any initiative to address data gaps relating to funds. In conducting this task, we appreciate the willingness to take existing data gathering as well as proportionality into consideration. Before requesting the collection of additional data it has to be ensured that regulators and supervisors make use of and verify the usefulness of all the data that are already being collected. In light of increasing reporting and disclosure requirements across the board the administrative burden of every new obligation should be limited as far as possible.

The envisaged review should not only extend to existing obligations but also cover those that are already under consideration. For example, in the United States the SEC recently finalized enhanced reporting rules for advisers and proposed new rules and forms to modernize and enhance data reporting and disclosure for funds. While the industry is generally supportive of this initiative concerns with regards to specific details of the proposal have been described in various comment letters. We note that a special focus is given to the reporting and disclosure of the liquidity and valuation of holdings. Assuming proper refinement of the proposal, upon availability, all this data will provide supervisors, policy makers and the general public with additional and very helpful insights.

We also encourage the FSB and IOSCO to play a stronger role in facilitating international information sharing among regulators and supervisors. As a matter of fact, much of the data that is already being collected is not being shared among various agencies and across jurisdictions. In this context we urge supervisors to make better use of the Multilateral Memorandum of Understanding. The industry is concerned about a lack in cooperation that leads to multiple requests from different sources and in different formats for the same data and leads to an unnecessary administrative burden. Regulators need to be more mindful of the cumulative impact of these requests, as ultimately the cost of data collection and production are borne by investors.

31 See SEC, supra (note 26).
32 See IOSCO, supra (note 27).
**Recommendation 2:** Authorities should review existing investor disclosure requirements and determine the degree to which additional disclosures should be provided by open-ended funds to investors regarding fund liquidity profiles, proportionate to the liquidity risks funds may pose from a financial stability perspective. Authorities should enhance existing investor disclosure requirements as appropriate to ensure that the required disclosures are of sufficient quality and frequency. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.

In general, we support enhanced disclosure as an appropriate means to increase transparency and market discipline. In conducting this task, we appreciate the willingness to take existing data gathering as well as proportionality into consideration. In light of increasing reporting and disclosure requirements across the board the administrative burden of every new obligation should be limited as far as possible.

**Recommendation 3:** In order to reduce the likelihood of material liquidity mismatches arising from an open-ended fund’s structure, authorities should have requirements or guidance stating that funds’ assets and investment strategies should be consistent with the terms and conditions governing fund unit redemptions both at fund inception and on an ongoing basis (for new and existing funds), taking into account the expected liquidity of the assets and investor behavior during normal and stressed market conditions. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.

A recent report by IOSCO highlights that in many jurisdictions guidance is already provided for fund design and many of the liquidity management tools. Where guidance is not imbedded in the national legislation or the regulatory framework, specific guidance is provided by the regulator through rules and guidance notices.33

Against this backdrop, the industry appreciates initiatives to develop best practices with regards to risk management tools. However, international harmonization should not be regarded as a panacea in this context. Rather, national specifics as well as proportionality should be recognized.

**Recommendation 4:** Where appropriate, authorities should widen the availability of liquidity risk management tools to open-ended funds, and reduce barriers to the use of those tools to increase the likelihood that redemptions are met even under stressed market conditions. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.

According to IOSCO liquidity management tools are available in all reporting jurisdictions. However, not every tool is available in every market.34

Against this backdrop, the industry welcomes the initiative to investigate if the availability of additional tools in certain markets can increase the likelihood that redemptions are met even under stressed market conditions.

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33 See *IOSCO, supra* (note 14), p. 12 and 15 (table 15).
34 *Id.*
Recommendation 5: Authorities should make liquidity risk management tools available to open-ended funds to reduce first-mover advantage, where it may exist. Such tools may include swing pricing, redemption fees and other anti-dilution methods. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.

We are convinced that ‘first mover advantages’ are not a prevalent phenomenon in the fund industry. A precondition for such an advantage that could lead to a ‘run’ on a complete asset class is a fixed repayment obligation competing for a limited amount of assets or a flawed pricing mechanism.

Nevertheless, we support the initiative to identify potential weaknesses in certain fund structures and in connection with certain asset classes and to make additional liquidity management tools available where appropriate. However, any such initiative must be fact based and data driven. IOSCO and its members should demonstrate the need for the availability of certain liquidity risk management tools and design them to certain markets, investment strategies and asset classes to be efficient and effective. The recent IOSCO report[^35] seems to be a good starting point for this endeavor. The industry looks forward to supporting IOSCO and its members in this task.

Recommendation 6: Authorities should require and/or provide guidance on stress testing at the level of individual open-ended funds to support liquidity risk management to mitigate financial stability risk. The requirements and/or guidance should address the need for stress testing and how it could be done. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.

In general, stress testing could potentially be a useful tool to inform asset managers and supervisors of the repercussions of a stressed market conditions and the ability of an open-ended fund to meet redemption requests of its investors in certain limited circumstances where there is empirical evidence of a potential inability to meet such requests in a timely manner. However, from the industry’s perspective, undifferentiated across the board stress-testing is not appropriate. The scope of any stress testing requirements and the calibration of the stress test assumptions should recognize differences among funds, existing regulatory requirements, shareholder demographics and historical behavior. Furthermore, it should be recognized that fund liquidity is less relevant for funds that have a variety of liquidity risk management tools available, such as the ability to meet redemption requests in part or completely by transferring assets in-kind, to introduce swing pricing, impose redemption fees or suspend redemptions.

Furthermore, we would be skeptical if stress testing would be developed into a model driven supervisory tool with the requirement that every single fund pass a stress test as for example banks of a certain size must under the Dodd-Frank Act Stress Test (DFAST) and its Comprehensive Capital Analysis and Review (CCAR) in the United States which are focused on capital adequacy and largely irrelevant to managers, who are agents, and to most funds, whose ability to employ leverage is already tightly capped and whose risk of insolvency is nonexistent for practical purposes. From the industry’s point of view these kinds of stress tests can lead to increased systemic risk if portfolio managers adjust their risk models and tools in order to pass a supervisory stress test that is based on certain common assumptions and models. If asset managers homogenize their behavior in order to pass supervisory stress tests this may finally introduce the kind of ‘herding behavior’ that has heretofore not existed and that other policy measures are intended to curtail.

[^35]: Id.
Recommendation 7: Authorities should promote (through regulatory requirements or guidance) clear decision-making processes for open-ended funds’ use of extraordinary liquidity risk management tools, and the processes should be made transparent to investors and the relevant authorities. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.

The industry welcomes consistent and transparent decision-making processes and structures within fund management organizations. However, we are not aware of any major deficiencies at this point in time. In particular, as IOSCO has recently recognized, regardless of the liquidity management tools and the reasons for being used, fund and asset managers generally disclose the ‘rules of the game’ upfront to investors.  

Recommendation 8: Authorities should provide guidance and, where appropriate and necessary, provide direction regarding open-ended funds’ use of extraordinary liquidity risk management tools. In this regard, IOSCO should review its existing guidance and, as appropriate, enhance it.

With regards to the suspension of redemptions as the most extraordinary – and ultimate – liquidity management tool, regulatory guidance is provided in most but not all jurisdictions. While the industry appreciates initiatives to develop best practices with regards to risk management tools we do not regard international harmonization as a panacea in this context. Rather, national specifics as well as proportionality should be recognized.

Recommendation 9: Where relevant, authorities should give consideration to system-wide stress testing that could potentially capture effects of collective selling by funds and other institutional investors on the resilience of financial markets and the financial system more generally.

While we recognize that stress testing may be useful on the level of certain individual funds (see our comment on Recommendation 6) we are skeptical about the merits of ‘macro’ or ‘system-wide’ stress-testing. In our view, the assumption of homogeneous behavior (sometimes also described as ‘herding’) of the majority of funds in line with other market participants is not supported by empirical evidence. Even portfolio managers within the same firm frequently trade in opposite directions with respect to the same security because their funds have different strategies and their clients have different investment objectives and constraints that cause them to make different investment decisions. Against this backdrop, funds regularly act as shock absorbers in times of market stress and funds flow into markets where prices have declined.

The above arguments are readily supported by data. Research has demonstrated that during periods of market stress dating back to 1945 and through the most severe financial crises, mutual fund investors have not reacted precipitously to financial market shocks. For example, in the 17-month period November 2007 to March 2009, U.S. equity funds experienced net cash outflows of $281 billion. The majority of these outflows ($205 billion) occurred during the peak of the financial crisis, July to December 2008. However, over these six months the net outflows amounted to just 3.6 percent of equity fund assets. While we concede that funds may experience increased redemptions in periods of high volatility and market stress there is no historical evidence that redemptions of fund investors have induced fire sales by

37 Id., p. 15 (table 6).
equity and bond funds and led to a collapse of securities prices and to the materialization of systemic risk. There is no empirical evidence to assert that they may do so in the future.

We endorse the views the FSB and IOSCO expressed in the First Consultative Document that “even when viewed in the aggregate, no mutual fund liquidations led to a systemic market impact throughout the [2000 to 2012] observation period. Part of the explanation may be that many US investors hold mutual fund shares for retirement purposes. As such these investors’ investment horizon could be long-term, whereby they would prefer to remain invested rather than cash-out during a market downturn.”

Most importantly, funds only represent a small portion of a diverse global marketplace and data is not available on many other market participants. In this context in particular we agree with IOSCO that only a holistic approach to the market that involves all relevant actors will lead to meaningful results. The effectiveness of performing a system-wide stress test without data that is representative of the entire system would be highly questionable.

Against this backdrop we challenge the validity of any system-wide stress-testing and the ability to design a useful test given the deficiencies of current models of the system. Therefore, we suggest this recommendation be eliminated as it will not result in meaningful information that can be used to inform policy decisions.

If the FSB and IOSCO nevertheless decided to embark on this endeavor any system-wide stress testing would have to be carefully designed and subject to public review and comment. In particular, any macro analysis must not mechanistically aggregate the results of individual stress-tests but has to recognize the heterogeneity of funds and their investors and in particular the potential market dynamics during hypothetical stress market events. Furthermore, such a model would also have to recognize the fact that roughly 75% of the world’s financial assets are not managed by third-party asset managers but by the asset owner directly. This is by no means an easy task nor is it prudent to expend significant resources on exercises that are unlikely to produce meaningful results.

**Recommendation 10: IOSCO should develop simple and consistent measure(s) of leverage in funds with due consideration of appropriate netting and hedging assumptions. This would enhance authorities’ understanding of risks that leverage in funds may create, facilitate more meaningful monitoring of leverage, and help enable direct comparisons across funds and at a global level. IOSCO should also consider developing more risk-based measure(s) to complement the initial measure(s) and enhance the monitoring of leverage across funds at a global level.**

As we have mentioned in our earlier submission there is no standard definition of leverage for the asset management industry. Regulatory frameworks in the United States, in Europe, and in Asia use different approaches to define, measure and limit leverage in investment funds. While we appreciate the FSB’s initiative aimed at increasing consistency and transparency with regard to this important risk factor this recommendation should not lead to the global harmonization of the definition of leverage in the context of supervision. Harmonization of definitions in the interest of globally consistent data collection may indeed require a ‘simple’ approach as a starting point but should recognize that the various types of funds and their profiles may justify more advanced and, where necessary, individually customized measures for dealing with leverage in the context of supervision. It is in the interest of all parties involved – investors, regulators, and asset managers – to make sure the different measures are appropriate for the various types

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40 See IOSCO, supra (note 5), p. 81.
of funds and for the purpose these measures are intended to serve. Further, we caution that some ‘simple’ measures of leverage can be quite misleading as to the risk of a particular portfolio.\(^{41}\)

For further details we refer to our answer to Q10 and Q11.

**Recommendation 11: Authorities should collect data on leverage in funds, monitor the use of leverage by funds not subject to leverage limits or which pose significant leverage-related risks to the financial system, and take action when appropriate.**

We strongly believe that in the context of the asset management sector the only relevant transmission channel for potential global systemic risk is the exposure (counterparty) channel via leverage in investment funds. This is where attention should be focused. Against this backdrop, we commend the FSB for developing policy recommendations aimed at measuring and monitoring the use of leverage in investment funds. However, it has to be recognized that the various types of funds and their profiles may justify more advanced and, where necessary, individually customized measures for dealing with leverage in the context of supervision.

**Recommendation 12: IOSCO should collect national/regional aggregated data on leverage across its member jurisdictions based on the simple and consistent measures(s) it develops.**

We support the collection of aggregated data across jurisdictions as an important tool to identify international interconnections and possible transmission channels for systemic shocks.

We encourage the FSB and IOSCO to play a stronger role in facilitating international information sharing among regulators and supervisors. As a matter of fact, much of the data that is already being collected is not being shared among various agencies and across jurisdictions. In this context we urge supervisors to make better use of the Multilateral Memorandum of Understanding.

**Recommendation 13: Authorities should have requirements or guidance for asset managers that are large, complex, and/or provide critical services to have comprehensive and robust risk management frameworks and practices, especially with regards to business continuity plans and transition plans, to enable orderly transfer of their clients’ accounts and investment mandates in stressed conditions.**

As a general observation, we recognize a contradiction between the FSB’s approach to identify ‘Vulnerabilities from Asset Management Activities’ and the limitation of certain policy measures to asset managers that are large or complex. We have argued consistently that ‘size’ is not a suitable indicator for global systemic risk in the asset management sector. Against this backdrop, we suggest to eliminate any reference to size in the policy recommendations.

Beyond standard industry practices we are not aware of any “critical services to other financial institutions (...) that might be challenging for other financial institutions to replace in a timely manner especially when markets are under stress.” Against this backdrop we do not see any reason to expand the scope of the analysis towards this kind of operational risk. If the FSB should come to a different conclusion we would argue that such critical activities would have to be regulated on an industry-wide basis.

\(^{41}\) For example, ‘Gross Notional Exposure’ has several known limitations that can result in misleading measures of leverage.
Irrespective of these general remarks we do not recognize operational risk in the asset management sector as a structural vulnerability that could cause or amplify a systemic risk to the global financial system. This recommendation is founded on conjecture based on incorrect assumptions about how asset managers operate. Against this backdrop, we do not recognize any benefit in ‘transition plans’ that extend beyond current business continuity plans which have become a standard tool among asset managers small and large. For further details we refer to our answer to Q15.

Recommendation 14: Authorities should monitor indemnifications provided by agent lenders/asset managers to clients in relation to their securities lending activities. Where these monitoring efforts detect the development of material risks or regulatory arbitrage that may adversely affect financial stability, authorities should verify and confirm asset managers adequately cover potential credit losses from the indemnification provided to their clients

Borrower default indemnification does not represent a systemic risk issue. Concerns about regulatory arbitrage are based on inaccurate assumptions. Securities lending activities by asset managers or funds and indemnifications that may be provided to certain securities lending clients are not a structural vulnerability that could cause or amplify a systemic risk to the global financial system. As we do not see any merits in monitoring a risk that is non-existent we suggest elimination of Recommendation 14. For further details we refer to our answer to Q17.

Q3. In your view, are there any practical difficulties or unintended consequences that may be associated with implementing the proposed policy recommendations, either within a jurisdiction or across jurisdictions? If there are any, please identify the recommendation(s) and explain the challenges as well as potential ways to address the challenges and promote implementation within a jurisdiction or across jurisdictions.

From the industry’s perspective it seems premature to make any assessments as long as the policy recommendations have not been substantiated in detail.

In general, we support enhanced data collection and disclosure as appropriate means to increase transparency and market discipline, in particular with regards to leverage. In conducting this task, we appreciate the willingness to take existing data gathering as well as proportionality into consideration. In light of increasing reporting and disclosure requirements across the board the administrative burden of every new obligation should be limited as far as possible.

While the industry appreciates initiatives to develop best practices with regards to risk management tools we do not regard international harmonization as a panacea in this context. Rather, national specifics as well as proportionality should be recognized.

In principle, stress testing of individual funds could potentially be a useful tool to inform asset managers and supervisors on the repercussions of a financial crisis and to field test the application of liquidity management tools and business continuity plans. However, stress testing should recognize the certain limited circumstances where there is empirical evidence of a potential inability to meet redemption requests in a timely manner. From the industry’s perspective, system-wide and undifferentiated across the board stress-testing of individual funds is not appropriate. The scope of any individual fund stress testing requirements and the calibration of the stress test assumptions should recognize differences among funds, existing regulatory requirements, shareholder demographics and historical behavior. Furthermore, it should be recog-
nized that fund liquidity is less relevant for funds that have a variety of liquidity risk management tools available, such as the ability to meet redemption requests in part or completely by transferring assets in-kind, to introduce swing pricing, impose redemption fees or suspend redemptions.

Furthermore, we would be skeptical if stress testing would be developed into a model driven supervisory tool with the requirement that every single fund pass a stress test as for example banks of a certain size must under the Dodd-Frank Act Stress Test (DFAST) and its Comprehensive Capital Analysis and Review (CCAR) in the United States, which are focused on capital adequacy and largely irrelevant to managers, who are agents, and to most funds, whose ability to employ leverage is already tightly capped and whose risk of insolvency is nonexistent for practical purposes. From the industry’s point of view these kinds of stress tests can lead to increased systemic risk if portfolio managers adjust their risk models and tools in order to pass a supervisory stress test that is based on certain common assumptions and models. If asset managers homogenize their behavior in order to pass supervisory stress tests this may finally introduce the kind of ‘herding behavior’ that has heretofore not existed and that other policy measures are intended to curtail.42

Liquidity mismatch between fund investment assets and redemption terms and conditions for fund units

Q4. In your view, is the scope of the proposed recommendations on open-ended fund liquidity mismatch appropriate? Should any additional types of funds be covered? Should the proposed recommendations be tailored in any way for ETFs?

First of all we do not believe that investors in open-ended funds in general are facing a ‘first-mover advantage’ in times of a crisis: A ‘first-mover advantage’ is characteristic for the depositor in a bank and is the textbook example of a prisoner’s dilemma that can indeed lead to a run on a certain bank and develop into a systemic crisis. The problem originates in the balance sheet of a bank: On the liability side a bank promises to repay the full amount of a customer’s deposit on demand whereas many assets, such as mortgage loans, are long-dated, illiquid, and hard to value as they depend on appraisals. Against the backdrop of this maturity and liquidity transformation a bank is typically unable to repay all its depositors at the same time and on short notice. If a deterioration in the quality of its assets raises concerns with regards to the solvency of a bank it is rational for each depositor to ‘run’ on the bank to withdraw his or her deposit and to leave the other depositors with worthless or at least illiquid claims once the bank’s cash funds run out.

Open-ended investment funds with a focus on listed securities (equity, fixed income) and a variable NAV typically do not show these characteristics. On the asset side of the balance sheet, a fund’s assets are liquid, marked to market or fair valued daily, and publicly disclosed regularly. On the liability side of the balance sheet, the repayment obligation of an investment fund is derived from the aggregate value of the assets. A fund promises to repay only the current value of a shareholder’s investment, based on the fund’s NAV next determined after the redemption request is made (typically as of the close of trading). That current value at which the shareholder must be redeemed is based on the daily value of the fund’s portfolio assets. These two features—the absence of a fixed repayment obligation competing for a limited amount of assets, combined with market/fair value pricing—effectively eliminate the conditions necessary for a ‘first-mover advantage’. Thus, a precondition for a crisis that could lead to a ‘run’ on a complete asset

42 In a broader context maintaining diversity in the system is an important means to fostering the stability of the system as such; see Beale, Nicholas et al., Individual versus systemic risk and the Regulator’s Dilemma, PNAS - Proceedings of the National Academy of Sciences of the United States of America, Vol. 108, No, 31, pp. 12647-12652 (http://www.ncbi.nlm.nih.gov/pmc/articles/PMC3150885/pdf/pnas.201105882.pdf).
class is a fixed repayment obligation competing for a limited amount of assets or a flawed pricing mechanism.

The latter is illustrated by the example of the Reserve Fund that triggered a run on prime Mutual Money Market Funds (MMMF). The run on prime MMMFs occurred after the Reserve Fund suffered losses on papers issued by Leman Brothers and ‘broke the buck’. This event raised widespread concerns regarding the quality of the assets held by other prime MMMFs, demonstrated the limitations of what is sometimes described as an implicit repayment guarantee and caused a crisis in this specific asset class. Not surprisingly, MMMFs with a constant NAV are at the center of a comprehensive regulatory overhaul in various jurisdictions.

An example for the former are real estate funds. In one of its recent studies IOSCO mentions liquidity problems in Australian, Dutch, and Spanish real estate funds during periods of high redemptions. However, problems with meeting increased redemption requests were addressed by applying the liquidity management tools at hand. In coordination with the supervising authorities the redemptions were finally suspended. Following this decision “(t)here was no sign of spillovers or any other symptoms that could indicate systemic risk.” A similar observation could recently be made in the United Kingdom: Six of the UK’s largest real estate funds had frozen almost £14.6 billion of assets after Britain’s vote to leave the EU caused an increased level of redemptions from UK property funds. As a result, more than half of the £25 billion of funds committed to commercial real estate by retail investors had utilized tools at their discretion to ensure all shareholders were treated fairly. Interestingly, several funds used different tools including implementing suspensions or redemption fees. While this is another example for a market event that triggered limited problems in a specific asset class it demonstrates that the problems in these funds could be managed with the existing tools and were far from igniting a systemic crisis – not even on a national scale.

As regards the specific question on Exchange Traded Funds (ETFs), we agree in general with the FSB’s analysis as provided in Annex 3 to the Consultative Document. As the Consultative Document rightly points out, ETF “investors generally do not sell or redeem their individual shares directly from the fund at NAV” because only authorized participants (APs) are able to redeem shares. Further, APs are institutional investors and generally redeem ETF-shares in-kind, which externalizes transaction costs from the fund. As such, the majority of ETFs do not meet redemptions by converting fund holdings to cash. To this end, in the course of implementing the proposed recommendations, care must be taken to ensure that any changes to existing regulation are relevant to the ETF structure. In some cases, we have observed that regulatory proposals designed to address concerns regarding a fund’s ability to convert holdings to cash in a given timeframe are not applicable for funds that meet redemptions in-kind.

Q5. What liquidity risk management tools should be made available to funds? What tools most effectively promote consistency between investors’ redemption behaviors and the liquidity profiles of funds? For example, could redemption fees be used for this purpose separate and apart from any impact they may have on first-mover advantage?

In major jurisdictions, portfolio managers have the ability to buffer the impact of redemptions by using a broad range of liquidity management tools (e.g., cash, inter-fund lending, committed or uncommitted lines of credit, delays in cash payout, payment in kind, short term redemption fees, or—as an ultimate measure—the suspension of redemptions) to respond to redemptions requests or by selling a proportionate share of all fund assets. In general, each portfolio manager will take a balanced and idiosyncratic approach that reflects the specific characteristics of the fund and its investors in order to minimize the impact of selling illiquid assets, while ensuring that a fund remains invested at its targeted asset allocation.
Liquidity risk management tools include: portfolio construction, swing pricing, redemption fees, anti-dilution levies, redemption gates, redemptions in kind, side pockets, and suspension of redemptions. As IOSCO has recently observed “(m)any liquidity management tools are available to jurisdictions, some of which are specifically tailored to the features and nature of the funds considered (e.g., money market funds, real estate funds, hedge funds).”

We concur with the FSB’s Recommendation 4 and support the initiative to encourage authorities to widen the availability of the various liquidity risk management tools and to reduce barriers to the use of those tools in order to increase the likelihood that redemptions are met even under stressed market conditions.

Q6. What characteristics or metrics are most appropriate to determine if an asset is illiquid and should be subject to guidance related to open-ended funds’ investment in illiquid assets? Please also explain the rationales.

It has to be observed that ‘liquidity’ is not an absolute standard. Any metric should recognize that liquidity is not a binary (‘liquid’ vs. ‘illiquid’) but a discrete measure that can fall or increase along a spectrum. Furthermore, liquidity can vary over time and it can differ from the perspective of different portfolio managers. In general, investment funds own and portfolio managers initiate trades in specific securities. Thus, any analysis would have to be based on the specific portfolio composition of an investment fund and the liquidity of each specific security.

Further, it has to be recognized that any liquidity measure must never been judged in isolation but has to be put into context with the available liquidity management tools. These do not only comprise statutory or contractual tools (e.g. redemption fees, redemption gates, redemptions in kind, suspension of redemptions) but also committed back-up lines of credit or inter-fund lending facilities.

Q7. Should all open-ended funds be expected to adhere to the recommendations and employ the same liquidity risk management tools, or should funds be allowed some discretion as to which ones they use? Please specify which measures and tools should be mandatory and which should be discretionary. Please explain the rationales.

The industry opposes a one-size-fits-all approach. In the industry’s view, fund-specific factors, including regulatory constraints, investor demographics, fund strategy, asset class, etc. require tailoring and the ability for the manager to exercise discretion.

We endorse IOSCO’s assessment that “the funds generally have shown to be responsible in their liquidity management through the types of assets in which they invest. Consequently, much of the responsibility for invoking liquidity management tools begins with the funds. (…) asset managers generally have a fiduciary duty with respect to investors and have activated liquidity management tools when they are in the best interests of fund shareholders.”

43 IOSCO, supra (note 14), p. iii.
44 The importance of the manager’s "good faith" or "reasonable" judgement for regulatory liquidity reporting is already explicitly recognized in the rubric of SEC's Form PF (Q32) and the AIFMD reporting template (items 178-184); see SEC, Form PF (Paper Version) (https://www.sec.gov/about/forms/formpf.pdf); European Securities and Markets Authority (ESMA), Guidelines on reporting obligations under Articles 3(3)(d) and 24(1), (2) and (4) of the AIFMD, 8.08.2014, ESMA/2014/869EN (https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-869.pdf).
We concur with the FSB’s Recommendation 4 and support the initiative to encourage authorities to widen the availability of the various liquidity risk management tools and to reduce barriers to the use of those tools in order to increase the likelihood that redemptions are met even under stressed market conditions. However, the primary judgement and responsibility to make use of certain liquidity management tools should rest with the singular portfolio manager.

As regards ETF’s we agree in general with the FSB’s analysis as provided in Annex 3 to the Consultative Document.

Q8. Should authorities be able to direct the use of exceptional liquidity risk management tools in some circumstances? If so, please describe the types of circumstances when this would be appropriate and for which tools.

Unfortunately, the FSB does not provide a definition of ‘exceptional liquidity risk management tools’. Assuming that ‘exceptional’ refers to the suspension of redemptions as the most extraordinary—and ultimate—liquidity management tool the regulators in the most important jurisdictions (France, Germany, Ireland, Luxemburg, United Kingdom, United States) already have the ability to activate suspensions of redemptions.46

We endorse IOSCO’s assessment that “the funds generally have shown to be responsible in their liquidity management through the types of assets in which they invest. Consequently, much of the responsibility for invoking liquidity management tools begins with the funds. (...) asset managers generally have a fiduciary duty with respect to investors and have activated liquidity management tools when they are in the best interests of fund shareholders.”47

Against this backdrop, the authority to mandate the application of exceptional liquidity management tools should be limited to exceptional circumstances (i.e. a systemic financial crisis) but should not only recognize systemic requirements but also the need to protect investors, to maintain fair, orderly, and efficient markets, and to facilitate capital formation.

Leverage Within Funds

Q11. Are there any particular simple and consistent measures of leverage or risk-based measures that IOSCO should consider?

As we have mentioned in our earlier submission there is no standard definition of leverage for the asset management industry. Regulatory frameworks in the United States, in Europe, and in Asia use different approaches to define, measure and limit leverage in investment funds. While we appreciate the FSB’s initiative aimed at increasing consistency and transparency with regard to this important risk factor the recommendations should not lead to the global harmonization of the definition of leverage in the context of supervision. Harmonization of definitions in the interest of globally consistent data collection may indeed require a ‘simple’ approach as a starting point but should recognize that the various types of funds and their profiles may justify more advanced measures for dealing with leverage in the context of supervision.

In this context it may be instructive to look at the key ratios that are used for the supervision of the banking sector: Regulators have decided to look at Common Equity Tier 1 (CET1), Total Loss Absorbing Ca-

46 See IOSCO, supra (note 14), p. 22 (table 11).
pacity (TLAC), the Supplementary Leverage Ratio (SLR), the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ration (NSFR). These metrics focus on leverage (first three) and financing liquidity (last two). CET1 and TLAC use risk weights for balance sheet items, while the SLR does not. All three measures use adjustments for derivatives. Obviously, bank regulators regard one single leverage number as insufficient for their purposes.

Given that the universe of funds is enormously more heterogeneous than the banking sector it is highly ambitious to think that a single ‘simple and consistent’ measure can on its own be a useful indicator for systemic risks in the asset management sector. Nevertheless, we support the FSB’s endeavor to create a common reporting framework as this would indeed represent an improvement as compared to the status quo.

As of today, the use of leverage in a number of investment products is subject to extensive regulation. We concur with the FSB and IOSCO that “many public funds currently have legal and regulatory limitations on their ability to use leverage (either balance-sheet leverage or synthetic leverage)”.

48 For example, U.S. mutual funds are subject to specific leverage limitations, both in connection with borrowing and the use of derivatives. In the European Union regulatory regimes under both the UCITS and the AIFMD framework similarly include explicit limits or disclosure obligations related to leverage.

Since the AIFMD framework is one of the newest and most comprehensive approaches and also provides some options to recognize the specific peculiarities of certain funds, we suggest that the FSB and IOSCO use the ‘Commitment leverage’ as defined in the AIFMD as a ‘simple and consistent measure’. As most asset managers are familiar with the AIFMD framework data collection along these lines would also be relatively easy to implement for much of the industry. Irrespective of the data collection work the industry asks the FSB and IOSCO to recognize that the various types of funds and their profiles may justify more advanced and, where necessary, individually customized measures for dealing with leverage in the context of supervision. It is in the interest of all parties involved – investors, regulators, and asset managers – to make sure the different measures are appropriate for the various types of funds and for the purpose these measures are intended to serve.

Q10. Should simple and consistent measure(s) of leverage in funds be developed before consideration of more risk-based measures, or would it be more appropriate to proceed in a different manner, e.g. should both types of measure be developed simultaneously?

As noted above, we suggest that the FSB and IOSCO use the ‘Commitment leverage’ as defined in the AIFMD as a ‘simple and consistent measure’ of leverage in funds. We recommend that other, more risk-based measures are only considered in the event that the Commitment leverage is found to be insufficient for regulatory requirements.

48 FSB/IOSCO, supra (note 20), p. 32.
49 AIFMD includes two measures of leverage: “gross leverage” provides a baseline measure of whether a fund is using derivatives and/or borrowing and to what degree. “Commitment leverage” provides a calculation designed to assess economic exposure obtained through the use of leverage by reflecting direct borrowings as well as derivatives exposure with netting allowed for many, but not all, macro/micro hedges as well as paired offsetting derivatives positions; see Article 8, Commission Delegated Regulation (EU) No 231/2013, of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision, L 83/1, 22.3.2013 (http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0231&from=EN).
Various commentators have, in responses to FSB, noted shortcomings in the Commitment approach and mentioned that in certain cases it is not risk-sensitive. In order to overcome these shortcomings the FSB and IOSCO could at a later stage take advantage either of the ‘Value-at-risk’ (VaR) method as already positively tested in the context of the UCITS Directive or of existing methodologies provided by the Basel Committee on Banking Supervision (BCBS) to convert derivative portfolios into risk amounts. This would enable regulators to consider more ‘risk-based’ measures in the context of the asset management sector using work that has already been done, thus avoiding the need to develop a new framework or methodology.

Another more advanced indicator for synthetic leverage to be considered at a later stage may be the volume of initial margin. For almost all types of financial contracts a fund may be required to post an initial margin upon inception of a transaction in addition to posting margin to cover any mark-to-market losses during the duration of a trade (variation margin). The initial margin is set by the creditor and is intended to cover any losses the counterparty might suffer from the moment a fund does not meet a margin call and thus triggers the termination of the trade until the completion of the closeout. Therefore, initial margin is set at a level estimated to cover the potential change in value while a trade is liquidated under stressful conditions. Margin calculations, whether for cleared or non-cleared derivatives, also take account of the relative riskiness of different derivative portfolios and their nonlinearity. Therefore the total initial margin posted by a fund is a good proxy for the risk of loss of that fund’s portfolio of derivatives and moreover is set by the creditor at a level which the creditor deems to be sufficiently conservative to provide protection.

If it is decided that other, more risk-based measures are to be used it must always be recalled that (as stated in the Consultative Document), “asset managers and their funds pose very different structural issues from banks and insurance companies. In contrast to banks and insurance companies (…), asset managers usually act as agents on behalf of their clients and are subject to fiduciary duties to act in the best interests of investors (…)”. Therefore, even if certain calculations are similar to those used by regulators in other financial sectors, leverage risks in the asset management sector and any metrics to reflect these risks must be assessed in the specific context of potential systemic risk arising from asset management.

**Q9. In developing leverage measures (Recommendation 10), are the principles listed above for IOSCO’s reference appropriate? Are there additional principles that should be considered?**

We agree with recognizing synthetic leverage as well as netting and hedging. Indeed this is reflected in the AIFMD framework\(^50\) which we favor as a ’simple and consistent measure’. This framework does not take account of ’directionality’ or ’model risk’ issues. However, dealing with minutiae like model risk seems to be inappropriate as long as more important considerations were not also addressed at the same time. For example, the relative riskiness of small cap equity holdings is very different to that of government bonds. Thus, considering risk weights for assets seems to be more important than dealing with rather abstract ’model risk’.

**Q12. What are the benefits and challenges associated with methodologies for measuring leverage that are currently in place in one or more jurisdictions?**

We refer to our answer to Q11.

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\(^{50}\) See Article 8 and Annex I, Commission Delegated Regulation (EU) No 231/2013 *supra* (note 49).
Q13. Do you have any views on how IOSCO’s collection of national/regional aggregated data on leverage across its member jurisdictions should be structured (e.g. scope, frequency)?

In order to limit the administrative burden of additional reporting requirements scope and frequency these requirement should follow existing aggregation levels and not increase the frequency of reporting.

Q14. Do the proposed policy recommendations on liquidity and leverage adequately address any interactions between leverage and liquidity risk? Should the policy recommendations be modified in any way to address these interactions? If so, in what ways should they be modified and why?

The systemic repercussions of leverage may be amplified if the leverage is used for investments in illiquid assets. However, this could be monitored with better data collection.

Efforts to limit leverage and/or derivatives use should take care not to inadvertently limit the ability of funds to manage liquidity. For example, in the fixed income space where structural changes to market liquidity have occurred, derivatives instruments can be used as liquid overlays to permit larger cash holdings while obtaining required exposures. It would be counterproductive for rules intended to limit leverage to inadvertently limit funds’ abilities to manage liquidity risk. Care should be taken to ensure that any new rules are well-calibrated to avoid any unintended outcomes in this regard.

Operational risk and challenges in transferring investment mandates or client accounts

Q15. The proposed recommendation to address the residual risks associated with operational risk and challenges in transferring investment mandates or client accounts would apply to asset managers that are large, complex, and/or provide critical services. Should the proposed recommendation apply more broadly (e.g. proportionally to all asset managers), or more narrowly as defined in Recommendation 13? If so, please explain the potential scope of application that you believe is appropriate and its rationales.

We do not recognize any practical or empirical justification for Recommendation 13. There is no evidence that operational risk within asset managers is a material threat to the solvency or stability of the managers themselves, let alone a threat to global financial stability. As the FSB and IOSCO (in their first NBNI G-SIFI consultation) and the FSOC have acknowledged, there is no evidence of a threat to financial stability from the operation or resolution of investment funds and their advisers and significant evidence demonstrating that neither threatens global financial stability.51 This is corroborated by the following observations:

First, the probability of an unforeseen failure of an asset manager is extremely low. Managers are agents of their clients. They provide services to investors for a fee and do not engage in principal risk taking as banks do. The risk of sudden insolvency of an asset manager is extremely low and evident in their balance sheets. Unlike other types of financial institutions, asset managers do not require resolution. Asset manager business models are based on the generation of revenue through investment management fees earned for managing client assets. In the event that clients become dissatisfied with a manager’s performance or a reputational issue occurs, clients may choose to terminate the manager and select a new manager to manage their assets. Unlike in the case of banks, where reputational issues can lead to a loss of funding for daily operations causing the bank to fail very rapidly, reputational issues for asset managers lead to a

51 See note 20 for further reference.
loss of revenue. While revenue declines eventually can put a manager out of business, such situations do not arise overnight. Insolvency is even less likely to occur as a result of operational risk, which is typically idiosyncratic, fixable, and insured. Further, client assets are not on asset manager balance sheets and are, therefore, not entangled in bankruptcy proceedings that would require resolution. In the unlikely event of insolvency, it is common for asset managers to be replaced or wound down as part of the normal business cycle, without any effects on the stability of the financial system, regardless of its state at the time.

As the FSB and IOSCO have acknowledged, the main reason for the limited impact of an asset manager’s failure is the fact that the asset management industry is highly competitive and service providers are highly substitutable. We agree with the FSOC that “clients have routinely replaced asset managers without significant impact in non-stressed situations.” The data show that the same is true in stressed markets. Any market impact is alleviated by the fact that in order to replace an asset manager—for whatever reason—assets would not have to be moved physically since they are being held by an independent custodian.

We are concerned that the FSB’s analysis fails to appropriately distinguish between funds as a separate legal entity, their managers and the custodians. If an asset manager goes out of business or an investor decides to substitute an asset manager the assets can remain with the same custodian in a client denominated account. Custodians hold the assets irrespective of which asset manager the asset owner selects to manage the respective assets. If the services of an asset manager are no longer available, clients can award the mandate to manage an existing portfolio of securities to another manager without touching the assets as such. Against this backdrop, the FSB’s analysis shows some serious flaws. In particular, if client accounts are moved from one asset manager to the other, the derivatives contracts don’t have to be terminated as these are contracts between the fund and a counterparty in which the asset manager is not involved.

The operational challenges in replacing ancillary services are limited to those that are in fact provided by the asset manager (e.g. risk models and compliance platforms). Most of the perceived challenges are in fact irrelevant as they ignore the direct contractual relationship between the fund and the custodian that is by no means impacted by a change in the asset manager. The legal and regulatory difficulties also seem to be either irrelevant or at least vastly exaggerated. For example, account openings for foreign depositories are irrelevant as the fund has all the necessary accounts in place. Furthermore and against the backdrop of the high competition in the asset management industry it seems to be unrealistic that a fund picks a new asset manager that is lacking authorizations by the relevant authority.

According to our experience, if funds were to be redeemed or assets to be transferred between custodians these transactions take place frequently without impact to financial stability, including in times of market stress. Even during the worst weeks of the recent financial crisis, investors were able to redeem funds and to transfer assets between managers seamlessly. During the whole crisis the transfer and settlement sys-

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52 The numbers of mutual funds and fund managers exiting the business each year are significant. For example, in the United States and in 2014 alone 362 funds were merged or liquidated and 25 fund sponsors left the business. The figures peaked in 2009 with 871 funds and 53 fund sponsors. See ICI, Response to Notice Seeking Comment on Asset Management Products and Activities, p. 75 (http://conferences.ici.org/pdf/15_ici_fsoc_ltr.pdf).

53 “In other words, the investment fund industry is highly competitive with numerous substitutes existing for most investment fund strategies”; FSB/IOSCO, supra (note20), p. 30.

54 FSO, supra (note 20), p. 77493.

55 We understand that in normal course of transitions today as a matter of practice, derivatives contracts are often terminated as part of the transition. However, what is market practice during normal circumstances is not a requirement. It is certainly possible for derivatives transactions to be transferred to a new manager, rather than terminated.
tems were able to process client requests without any major delays.\textsuperscript{56} We note that managers and other service providers already process a high volume of asset transfers daily and the crisis exposed no weaknesses in the processes that threatened financial stability.

Furthermore, we do not think that size and complexity of an asset manager pose any problem in this context. Conversely, it is widely recognized that large, global managers have an advantage when it comes to stability and business continuity management in the face of business disruptions in a particular region or country (e.g., power outage, hurricane, earthquake, etc.) because they have the ability to shift operations to other offices or regions that may not be affected by the disruption. Managers that only operate in one country are more exposed to such calamities. Thus, if and when operational problems do occur within an asset management group they are typically remedied without any disruption in service. Even if there is a temporary disruption due to external factors it is likely to be limited to a few highly substitutable entities. However, these events will not result in direct financial losses to the investors they serve. For example, if the investors in a mutual fund cannot redeem their shares temporarily due to a system outage their assets have not been lost. They remain safe with the custodian bank. Thus, the temporary unavailability of the assets does not create a systemic disruption to the financial system.

Finally, beyond standard industry practices we are not aware of any “range of financial services to other financial institutions, such as pricing models or information technology (IT) platforms that might be challenging for other financial institutions to replace in a timely manner especially when markets are under stress” and that “are integral to other market participants’ daily operations, risk management, and/or investment decision making.” Against this backdrop we do not see any reason to expand the scope of the analysis towards this kind of operational risk. If the FSB should come to a different conclusion we would argue that such critical activities would have to be regulated on an industry-wide basis.

**Securities lending activities of asset managers and funds**

Q16. In your view, what are the relevant information/data items authorities should monitor for financial stability purposes in relation to indemnifications provided by agent lenders/asset managers to clients in relation to their securities lending activities?

As stated earlier in the document, borrower default indemnification is not a systemic risk issue and we are, therefore, uncertain why the FSB has focused on this area of limited risk.

To the extent the FSB would like to collect data on borrower default indemnification, it is imperative that information about the value of collateral posted is also collected. This is because indemnification is only triggered if there is a shortfall between the value of the loan and collateral so attempting to draw conclusions regarding risks of borrower default indemnification based only on the value of securities loans that receive indemnification would be inaccurate and misleading.

Q17. Should the proposed recommendation be modified in any way to address residual risks related to indemnifications? For example, should it be more specific with respect to actions to be taken by authorities (e.g., identifying specific means for covering potential credit losses) or more general (e.g., leaving to authorities to determine the nature of appropriate action rather than specifying coverage of potential credit losses)?

Some asset managers act as lending agents for their customers by arranging securities loans between lenders and borrowers. Over decades it has been the practice of lending agents to offer to some lenders indemnification against ‘borrower default’—i.e., the borrower failing to return the securities that have been lent. This indemnification, however, is limited to the ‘shortfall’ that could occur in the event the collateral delivered is insufficient to acquire replacement securities for those out on loan. Thus, borrower default indemnification is only triggered if the counterparty defaults and the collateral is insufficient to cover the cost of replacing the securities. To our knowledge such claims are extremely rare. We are not aware that securities loans indemnifications have ever been triggered to any sizeable extent—not even in the recent financial crisis.

Against this backdrop, we do not see borrower default indemnification as a systemic risk issue. We suggest Recommendation 14 to be dropped.

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Conclusion

We believe that the application of targeted regulation to properly defined and identified risks on an activity- or industry-wide basis is the most appropriate response to systemic risks. Against this backdrop we commend the FSB for focusing their analysis and their policy recommendations on certain activities. However, we reiterate our view that in the context of the asset management sector the only relevant transmission channel for systemic risk is the exposure (counterparty) channel via leverage. In comparison with leverage liquidity mismatches are only of secondary importance. Further, we do not recognize securities lending activities of asset managers and funds or operational risk and challenges in transferring investment mandates or client accounts as ‘structural vulnerabilities’.

In general, we support enhanced disclosure as an appropriate means to increase transparency and market discipline. In conducting this task, we appreciate the willingness to take existing data gathering as well as proportionality into consideration. While we appreciate the FSB’s initiative aimed at increasing transparency with regard to leverage the necessary simplifications in the interest of international data gathering should not lead to the global harmonization of the definition of leverage in the context of supervision.

Further, the industry appreciates initiatives to develop best practices with regards to liquidity risk management tools. However, international harmonization should not be regarded as a panacea in this context. Rather, national specifics as well as proportionality should be recognized.

Finally, we support the initiative to identify potential weaknesses in certain fund structures and in connection with certain asset classes and to make additional liquidity management tools available where appropriate. However, any such initiative must be fact based and data driven and has to recognize fund-specific

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factors as well as the ability for the manager to exercise discretion. The industry looks forward to supporting IOSCO and its members in this task.

We hope these comments are useful as the FSB and IOSCO consider the way forward in this area. Given the complexity of these issues, we believe direct dialogue with the industry is essential and appreciate the FSB and IOSCO’s willingness to engage in that dialogue. The IIF and its Non-Bank Non-Insurer Working Group stand ready to provide additional views or clarifications.

Should you have any questions on the issues raised in this letter, please contact Andres Portilla (aportilla@iif.com), or Thilo Schweizer (tschweizer@iif.com).

Very truly yours,

Andres Portilla

cc: Paul Andrews, IOSCO