association of the
luxembourg fund industry

Luxembourg, 7 April 2014

Response to IOSCO/FSB consultation "Assessment methodologies for identifying non-bank non-insurer global systemically important financial institutions"

Introduction

The Association of the Luxembourg Fund Industry (ALFI), the representative body for the Luxembourg investment fund community, was founded in 1988. Today it represents over a thousand Luxembourg-domiciled investment funds, asset management companies and a wide variety of service providers including depositary banks, fund administrators, transfer agents, distributors, law firms, consultants, tax advisers, auditors and accountants, specialist IT providers and communications agencies.

According to the latest figures of the Luxembourg financial supervisory authority CSSF (February 2014), total net assets of undertakings for collective investment (UCI) were EUR 2,679,511 million. There are 3, 881 undertakings for collective investment in Luxembourg, of which 2,530 are multiple compartment structures and 1,351 single-compartment UCIs. There are 13,674 active sub-funds in Luxembourg.

We thank the International Organization of Securities Commissions and Financial Stability Board for the opportunity to participate in this consultation.

We support the submission of the European Fund and Asset Management Association (EFAMA).

General remark

In general, ALFI considers that highly regulated funds such as UCITS in Europe or regulated Alternative Investment Funds (AIFs) that already comply with detailed diversification rules and rules on leverage are not systemically important and do not cause systemic risk.
In addition, asset managers are also not a source of systemic risk. They are not the counterparty to trades they conduct on behalf of their clients. Neither are they responsible for the allocation by clients of their assets. Managers act as agents for their clients.
Many funds and asset managers exit the business every year, and none of them require government intervention or taxpayer assistance.
As further explained in our response to this consultation, we consider it more appropriate to focus on market activities that may give rise to such issues.

In terms of method, we would like to make the point that it is rather difficult to assess the appropriateness of the proposed methodologies and to make detailed comments on the proposed indicators of systemic relevance without having any clear view on what the implications of a designation as G-SIFI would concretely be for the financial entities concerned. Against this background, we believe that it will be extremely important that any measures or potential remedies to be applied to systemically important financial entities will be subject to a robust public consultation process (as is the case for the definition of the methodologies leading to a potential G-SIFI designation).

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Response to the consultation

1. Systemic risk and transmission mechanisms

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

i) Exposures/counterparty channel
In our view, highly regulated funds such as UCITS or regulated Alternative Investment Funds (AIFs) do not cause systemic risk. However, we agree that this could be relevant to highly leveraged or concentrated hedge funds. Such funds have no or less stringent rules on leverage.

ii) Asset liquidation/market channel
We consider this to be less appropriate, particularly as mutual funds such as UCITS and AIFs have opportunities to use techniques such as gates, deferral of payment, redemption in kind, side pockets, suspension of dealing.
Mutual funds impacted by market liquidity issues and through their own dealing activities may either relieve pressure on market liquidity or even contribute to an increase, but such mutual funds do not cause market liquidity issues.
However, should forced liquidations be required, when a fund has a concentration, for example, a large investment in a single country, it is the fund investors that are impacted in terms of value or liquidity. Such risks are part of the investment strategy and communicated to and accepted by the investor upon initial investment.
We do not believe that such occurrences would lead to systemic risk issues. Indeed, as IOSCO and the FSB point out in section 6.2.1 of the consultation, funds contain characteristics that differentiate them from banks in such instances. In particular, fund investors absorb the negative effects that might be caused by the distress or even the default of a fund, thereby mitigating any eventual contagion effects in the broader financial system.
It should also be noted, however, that highly regulated funds such as UCITS have strict diversification rules that would limit the impact of concentrated investment on fund investors.

iii) Critical function / service substitutability
As stated by IOSCO and the FSB, the third channel on critical function or service/substitutability is not applicable to investment funds.

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

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

i) Size – No
ALFI considers that using size to screen funds will generate false positive indicators and false negative indicators. A large well diversified vehicle with little leverage, such as an index fund, is unlikely to pose systemic risk issues. Conversely, the Reserve Fund would not have met the proposed size thresholds.

However with respect to activity and in particular leverage (see below), the scale of that activity may have a relevance to systemic risk.

ii) Interconnectedness – Yes
We agree that interconnectedness is an adequate criterion to determine systemic importance, especially the use of leverage.

iii) Substitutability – No
In our view, substitutability is less likely a cause of systemic risk, because asset managers act as agents for their clients and there is considerable competition. Investors can always make a free choice to move to a different asset manager, or to a different investment strategy or to a different fund vehicle.
As a result, ALFI does not consider the principle on substitutability as an indicator to adequately capture how failure of NBNI financial entities could cause significant disruption to the wider financial system and economic activity. We consider that there should be enough substitutability in the market and the assessment of a particular fund's substitutability would require a case by case analysis of the fund's specific features.

iv) Complexity – Somewhat Yes
Considering certain investment strategies, we agree on the criterion of complexity, but it would be incorrect to consider that a given quantitative increase in activity encompassed an equivalent or indeed any higher level of complexity.

v) Global activities (cross jurisdictional activities) – No
Regarding the cross-jurisdictional presence, one has to bear in mind that investment funds are domiciled in only one jurisdiction, from which they can be distributed to other countries. This is not comparable to the situation of banks which may have subsidiaries in different jurisdictions. If a fund's investment strategy fails, this will concern the fund legal entity in the jurisdiction in which the fund is domiciled as well as the distribution to other countries, but not to other legal entities abroad.

Other Impact Factors that should be considered:

Leverage:

Instead of some of the proposed impact factors above, leverage should be considered as a better measure for screening funds. Those funds with substantial leverage should then be subjected to a more detailed review. Additional factors such as stability of funding sources, and concentrations of illiquid securities could also be considered.

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

ALFI considers that highly regulated funds such as UCITS funds and regulated AIFs that comply with detailed diversification rules and rules on leverage do not cause global systemic risk. We consider it more appropriate to focus on market activities of funds. Appropriate reporting and / or rules should apply to highly leveraged or concentrated hedge funds.

Asset managers are also not the source of systemic risk. They are not the counterparty to trades they on behalf of their clients. Neither are they responsible for the allocation by clients of their assets.

Asset managers act as agents for their clients' investments. It is important to note that the clients' investments which are entrusted to asset managers are not the asset manager's property and are held separately from the asset manager's balance sheet.

ALFI considers that asset managers, funds and their corporate structures would not fall within the definition of finance companies or market intermediaries as defined in the consultation paper. We would be grateful for confirmation of this point.

3. Operational framework for NBNI G-SIFI methodologies

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

ALFI considers that long-only funds do not present systemic risk or liquidity issues, whereas large investors that use substantial leverage or concentration may be more relevant to global systemic risk. We agree that the global financial environment could be further improved. But for investment funds the focus should be on market activity, such as cash management products, leverage, securities financing transactions, ETFs, market liquidity, global harmonisation of reporting, central counterparty (CCP) resolution.

Moreover, there are many techniques available in regulated fund prospectuses to assist fund liquidity as already outlined in the IOSCO Principles of Liquidity Risk Management for Collective Investment Schemes such as:

- Special spreads / price swinging
- Gates
- Redemption accepted but Payment deferred
- Side pockets
- Redemptions in kind
- Suspension of dealing

Q3-2. In your view, are the above proposed materiality thresholds (including the level) for the NBNI financial entity types appropriate for providing an initial filter of the NBNI financial universe and limiting the pool of firms for which more detailed data will be collected and to which the sector-specific methodology will be applied? If not, please provide alternative proposals for a more appropriate initial filter (with quantitative data to back-up such proposals).

ALFI considers that using size to screen funds will generate false positive indicators and false negative indicators. A large well diversified vehicle with little leverage, such as an index fund, is unlikely to pose systemic risk issues. Conversely, the Reserve Fund would not have met the proposed size thresholds.

"Leverage" is a better measure for screening funds that may be the source of systemic risk. Those funds with substantial leverage should then be subjected to a more detailed review. Additional factors such as stability of funding sources, and concentrations of illiquid securities would be considered.

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

The materiality criteria suggested for investment funds (100 billion USD in net AUM or, for hedge funds, 400-600 billion USD in GNE) are readily available or relatively easy to calculate. The fact, however, that materiality criteria are relatively simple to use and effective in narrowing down the pool of investment funds subject to further assessment does not mean that these criteria are necessarily the most appropriate to identify those financial entities that are most likely to be a source of systemic risk.

Once again, we do not believe that an initial filtering of investment funds based exclusively on their size is the best possible approach. For investment funds the focus should be on market activity.

For families of funds, the various categories for determining systemic importance, e.g. nature of investment strategy, may not be easy to align in reality. It would be critical to clearly define the notion of "families of funds" in order to be able to determine reliable quantification.

Challenges will be presented in capturing dark pools or other less transparent activities.

We believe that the terms used in this section require clarification. It is unclear whether the term "funds" applies at the compartment or umbrella level. Additionally, it is difficult to determine whether the term "families of funds" applies to funds where the asset manager is the same or to funds with a similar investment strategy. We believe that the former may lead to the situation whereby different legal structures are amalgamated for little purpose or reason.

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

The level of leverage used by hedge funds can differ significantly, that's why this category is difficult to capture.
We believe that it is inappropriate to penalise well diversified funds, such as UCITS or regulated AIFs with a lower threshold while hedge funds, which are not defined in the paper and may undertake more systemically important activities are allowed larger thresholds.

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

We do not believe that it is beneficial to set thresholds on "global activity" when this is not defined. We consider that diversified investors and assets pose less of a problem. As already mentioned, for funds the level of leverage could be taken as a further threshold.

<u>4.-5. Sector-specific methodologies for finance companies / market intermediaries</u>

As representative body of the Luxembourg funds industry, our response focuses on sector-specific methodologies for investment funds, and not on the proposed methodologies for finance companies and market intermediaries. We do not believe that these sections should apply to asset managers or funds.

6. Sector-specific methodologies: Investment funds

In general, ALFI considers that highly regulated funds such as UCITS funds or regulated AIFs that comply with detailed diversification rules and rules on leverage are not systemically important and do not cause global systemic risk. As a consequence, they should not be submitted to the proposed methodologies.

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

The definition appears too narrow. We suggest a broader definition approach such as that adopted for alternative investment funds in the Alternative Investment Fund Managers Directive[1].

There would appear to be a considerable inconsistency to include Collective Investment Schemes but to – rightly – exclude separately managed accounts. Separately managed accounts are owned by individual clients and are managed in compliance with each client's investment guidelines. These can be considered as "fund for one" with no first mover advantage issues. These portfolios are subject both to general asset management regulation (e.g. SEC and CFTC in US, FCA in UK, Japan FSA in Japan) and to each client's regulation (e.g. Department of Labor for US ERISA pension plans, or insurance regulators for insurance companies). These portfolios are typically conservatively managed: i) most separate accounts use no leverage and those that do, use a modest amount, ii) likewise, separate accounts are not typically invested in large concentrations of illiquid securities.

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

Asset managers are not the source of global systemic risk. Managers are not the counterparty to trades they conduct on behalf of their clients. Neither are they responsible for the allocation by clients of their assets. Asset managers act as agents for their clients' investments. It is important to note that the investments managed by asset managers are separate from those of the firm. For example, in the case of a UCITS, the fund board appoints the investment manager to manage its investments, while these investments are held by a custodian/depositary that is independent of the asset manager.

Concerns relating to the herd behaviour by institutional clients (e.g. out of one asset class into another) would need to be addressed directly with "asset owners" rather than with their agents. It is also important to note that "herding" behaviour is a normal activity in markets and should not be seen in isolation as an indicator of "systemic importance".

Clients regularly change managers with no impact on the capital markets. In the unlikely event a manager went out of business, clients would move to one of many competitors who would then manage the client's assets which are held separately from those of the asset manager.

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[1] Art. 1(a) AIFMD: "AIFs" means collective investment undertakings, including investment compartments thereof, which raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors and do not require authorisation pursuant to Article 5 of Directive 2009/65/EC.

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

In general, ALFI considers that highly regulated funds such as UCITS in Europe or regulated Alternative Investment Funds (AIFs) that already comply with detailed diversification rules and rules on leverage are not systemically important and do not cause systemic risk.
In addition, asset managers are also not a source of systemic risk.

(i) individual investment funds

ALFI considers that not all investment funds are alike, and many of them are not systemically important or do not cause systemic risk.
There is a strong case to exclude:

- Heavily regulated funds such as UCITS in Europe and regulated AIFs where there is already a strong focus on diversification and funds built to meet investor liquidity expectations.
- Highly regulated money market funds where there are parallel developments

The focus should be on activity rather than on size of funds.

Concerning investment funds: two systemic risk transmission channels are suggested: on the one hand, the “Exposures / counterparty channel”, on the other hand the “Asset liquidation / market channel”.

- Exposures / Counterparty channel

The systemic risk channel suggested is that upon failure of an investment fund, fund liabilities would exceed shareholder capital such that market participants would suffer losses.
In our view, highly regulated funds such as UCITS or regulated AIFs do not cause systemic risk.
However, we agree that this could apply to highly leveraged or concentrated hedge funds. Such funds have no or less stringent rules on leverage.

- Asset liquidation / market channel

There are many techniques available in fund prospectuses to assist fund liquidity as already defined in the IOSCO Principles of Liquidity Risk Management for Collective Investment Schemes such as:

- Special spreads / price swinging
- Gates
- Redemption accepted but Payment deferred
- Side pockets
- Redemptions in kind
- Suspension of dealing

Certain types of funds will be more diversified and more liquid than others and this should be taken into account when considering funds as SIFI.

Moreover, as IOSCO and the FSB point out in section 6.2.1 of the consultation, funds contain characteristics that differentiate them from banks. In particular, fund investors absorb the negative

effects that might be caused by the distress or even the default of a fund, thereby mitigating the eventual contagion effects in the broader financial system.
The investor is made aware of the potential for loss in the funds constitutional documents and marketing materials prior to investment and accepts those risks upon investment.

(ii) family of funds

It is the activities of certain types of investment funds that are important rather than the funds themselves.
As mentioned above, it would be critical to clearly define the notion of "families of funds" in order to be able to provide accurate data.

Any focus should be on a common investment strategy, not a common manager. Nevertheless, quantification under a "families of funds" approach would introduce complexity without providing any clarity on systemic risk. All funds managed by a firm or in a legal fund family represent a diverse set of strategies and exposures that cannot call on the assets or support of legally separate entities in the event of its failure.

With respect to *(iii)* and to *(iv):*

(iii) asset managers on a stand-alone entity basis and
(iv) asset managers and their funds collectively

The asset management business model is fundamentally different than that of other financial institutions, such as:

- Commercial banks
- Investment banks
- Insurance companies
- Government-sponsored enterprises

Asset management entities do

- Act as agents for their clients
- Rely on a generally stable fee based income stream.
- Receive regulatory oversight at both the manager and portfolio levels

Asset management entities do not

- Invest with their own balance sheets by engaging in principal trades with clients
- Employ balance sheet leverage
- Guarantee investor principal
- Have access to central bank liquidity

It is the clients of asset management entities that are exposed to market volatility and who enjoy principal gains and losses not Asset Management entities themselves.

Asset management entities are exposed to operational and reputational risks but these will be specific to each entity and unlikely to be systemic in nature.

For the above reasons we do not believe that asset management entities should be considered G-SIFIs (globally systemically important finance institutions) either on a stand-alone basis or when considered with their funds collectively.

Clients regularly change managers, typically using the services of transition managers with no impact on the markets. In the rare event that a manager goes out of business, clients would be able to move to another competitor while their investments would be segregated from those of the manager.

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

It is the activities of certain types of investment funds that are important rather than the funds themselves. For example, cash management, leverage and market liquidity could form the basis of methodologies for hedge funds.

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

- Asset liquidation / market channel appears to be a much less important indicator than Exposures / Counterparty channel.
  - As outlined in Q 6-3 (i) a fund has many mechanisms available to it to manage shareholder liquidity expectations.
  - Considering the impact of fund liabilities on market participants after shareholder capital is exhausted, the discussion is less about the nature of the assets but more about the leverage that can be created by use of certain assets which indicates that exposures / counterparty channel is more relevant.

ALFI comments on the proposed indicators:

- Indicator 1-1 Size (net assets under management for the fund and, for hedge funds, gross notional exposure):

  ALFI considers that using size to screen funds will generate false positive indicators and false negative indicators. A large well diversified vehicle with little leverage, such as an index fund, is unlikely to pose systemic risk issues. Conversely, the Reserve Fund would not have met the proposed size thresholds.
  However with respect to activity and in particular leverage (see below), the scale of that activity may have a relevance to systemic risk.

- Indicator 2-1 Leverage ratio:
  Leverage is a better measure for screening funds. Those funds with substantial leverage should then be subjected to a more detailed review.

- Indicator 2-2 Counterparty exposure ratio:
  We agree that this is an appropriate indicator to measure systemic risk.

- Indicator 2-3 Intra-financial system liabilities:
  We agree that this is an appropriate indicator to measure systemic risk.

- Indicator 3-1 Turnover of the fund related to a specific asset / daily volume traded regarding the same asset:
  We agree that this could be an appropriate indicator to measure systemic risk.

  In our view, substitutability is less likely a cause of systemic risk, because asset managers act as agents for their clients and there is considerable competition. Investors can always make a free choice to move to a different asset manager, or to a different investment strategy or to a different fund vehicle.

  As a result, ALFI does not consider the principle on substitutability as an indicator to adequately capture how failure of NBNI financial entities could cause significant disruption to the wider financial system and economic activity. We consider that there should be enough substitutability in the market and the assessment of a particular fund's substitutability would require a case by case analysis of the fund's specific features.

  However should one fund not just have a significant concentration but also have a significant exposure to one entire issue, then this could be a relevant indicator.

- Indicator 3-2 Total fund turnover vs. total turnover of funds in the same category/classification:
  We disagree because, as outlined above, in this respect substitutability should not be defined by turnover. Asset managers act as agents for their clients and there is considerable competition. Investors can always make a free choice to move to a different asset manager, or to a different investment strategy or to a different fund vehicle.

  In any case turnover generated only by investment or disinvestment caused by subscriptions/ redemptions should be excluded.

- Indicator 3-3 Investment strategies (or asset classes) with less than ten market players globally:
  We disagree because substitutability should not be defined by investment strategy (or asset classes). Asset managers act as agents for their clients and there is considerable competition. Investors can always make a free choice to move to a different asset manager, or to a different investment strategy or to a different fund vehicle.

- Indicator 4-1 OTC derivatives trade volumes at the fund /Total trade volumes at the fund:
  We agree that this is an appropriate indicator to measure systemic risk.

- Indicator 4-2 Ratio of collateral posted by counterparties that has been re-hypothecated by the fund:
  We agree that this is an appropriate indicator to measure systemic risk.

- Indicator 4-3 Ratio of NAV managed using high frequency trading strategies:
  We agree but this links to 3-2 and 3-3 above. 'High frequency trading' is not defined and there are difficulties in coming up with only one definition. High frequency trading could be an indicator of systemic risk but this does not necessarily follow and individual fund circumstances must be examined e.g. a money market fund may have a high level of trading but this does mean that it is creating systemic risk.

- Indicator 4-4 Weighted-average portfolio liquidity (in days) / Weighted average investor liquidity (in days):
  We agree that this is an appropriate indicator to measure systemic risk.

- Indicator 4-5 Ratio of unencumbered cash to gross notional exposure (or gross AUM):
  We agree that this is an appropriate indicator to measure systemic risk.

- Indicator 5-1 Number of jurisdictions in which a fund invests:
  We disagree because many funds such as UCITS or regulated AIFs in Europe must meet detailed diversification rules to comply with the principle of risk spreading. This diversification occurs at an issuer and or group level but also at a sector/country/regional level. These characteristics apply across similar funds. The number of jurisdictions in which a fund invests is therefore not an indicator of systemic importance or risk and if anything, an increase in jurisdictions should reduce any systemic risk.

- Indicator 5-2 Number of jurisdictions in which the fund is sold / listed
  We disagree because an increase in jurisdictions in which the fund is sold / listed creates diversification in the investor base. The number of jurisdictions in which a fund's investors are based is therefore not an indicator of systemic importance or risk and in fact diversification of investor base must decrease systemic risk.

- Indicator 5-3 Counterparties established in different jurisdictions:
  We disagree because an increase in counterparties creates diversification and reduces the risks to a mutual fund. The location of a fund's counterparties is not an indicator of systemic importance or risk.

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

The proximity of the fund regulator to the fund custodian should be irrelevant to the likelihood of impact on market participants if fund liabilities were to exceed shareholder capital.

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

AUM and GNE are measures which could be used to assess the size of a fund, however:

Assets under Management:

Size by itself is not a sufficient screen as a large index fund or an unleveraged long-only fund is unlikely to give rise to systemic risk issues.

The activity that the fund carries out, not its absolute size, is most relevant to whether or not a fund should be considered as a source of systemic risk.

A focus on those funds with substantial leverage would be more appropriate, provided sufficient weight is given to understanding the purposes for which leverage is incurred by the fund. Further considerations such as stability of funding sources, and concentrations of illiquid securities should be included.

Gross Notional Exposure:

GNE does not take hedges or offsetting positions into account and thereby can be inaccurate and misleading as a measure of size or leverage.

The Commitment approach may be more accurate and therefore a better measure than GNE as funds report leverage after limited netting of matching positions and it is also being used under AIFMD reporting.

We believe that it is inappropriate to penalise well diversified funds, such as UCITS with a lower threshold while hedge funds, which are not defined in the paper and may undertake more systemically important activities are allowed larger thresholds.

Q6-8. Is the definition of “investment strategies” sufficiently clear for assessing the “substitutability” (indicator 3-3)?

ALFI does not consider the principle on substitutability as indicator to adequately capture how failure of NBNI financial entities could cause significant disruption to the wider financial system and economic activity. We consider that there should be enough substitutability in the market and the assessment of a particular fund’s substitutability would require a case by case analysis of the fund’s specific features.

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

ALFI fears that the costs of data collection would be substantial and must be estimated as they are not readily available.

We also note that Form PF in the US and AIFMD reporting (which comes on line post July 2014) ask a comprehensive set of questions as to the identity and exposure to counterparties, the extent of the purposes to which leverage is used as well as the liquidity of the fund’s portfolio. Once reporting for these forms is fully operational, regulators will have a comprehensive data set with which to measure potential build of systemic risk.

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

We would prioritise understanding the potential impact of leverage considering issues such as stability of funding sources, and illiquidity.

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

See comments above concerning leverage.

7. Guiding methodology for all other NBNI financial entities

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

ALFI thinks that highly regulated funds (such as UCITS funds and regulated AIFs that must comply with detailed diversification rules and rules on leverage) do not cause systemic risk. We consider it more appropriate to focus on market activities. Adequate rules could apply to highly leveraged or concentrated hedge funds.

Asset managers are also not the source of systemic risk. They are not the counterparty to trades they conduct on behalf of their clients. Neither are they responsible for the allocation by clients of their assets. Managers act as agents for their clients' investments. It is important to note that the investments managed by asset managers are separate from those of the asset management firm. For example, in the case of a UCITS, the fund board appoints the investment manager to manage its investments, while these investments are held by a custodian/depositary that is independent of the asset manager.