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Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
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Submitted via email to: fsb@fsb.org

28 February 2025

Dear Sir or Madam,

AIMA comments on the Leverage in Non-bank Financial Intermediation consultation report

The Alternative Investment Management Association ("AIMA")[1] welcomes the opportunity to respond to the Financial Stability Board (the "FSB") consultation report, "Leverage in Non-bank Financial Intermediation" ("NBFI").[2]

The Report restates a range of existing sectoral requirements with the expectation that NBFIs will apply those appropriate to them. AIMA believes it would be more prudent to assess first the effect of current and new regulatory requirements applicable to this sector, including the clearing requirements in U.S. Treasury markets, the data they provide and the behaviour they may drive. It will then be possible to

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1 AIMA is the world's largest membership association for alternative investments managers. Its membership has more firms, managing more assets than any other industry body and, through our 10 offices located around the world, we serve over 2,000 members in 60 different countries. AIMA's mission, which includes that of its private credit affiliate, the Alternative Credit Council (ACC) is to ensure that our industry of hedge funds, private market funds and digital asset funds is always best positioned for success. Success in our industry is defined by its contribution to capital formation, economic growth, and positive outcomes for investors, while being able to operate efficiently within appropriate and proportionate regulatory frameworks. AIMA's many peer groups, events, educational sessions, and publications, available exclusively to members, enable firms to actively refine their business practices, policies, and processes to secure their place in that success. For further information, please visit AIMA's website, www.aima.org.

2 *See* FSB "Leverage in Non-bank Financial Intermediation" (18 December 2024) (the "Report"), available at https://www.fsb.org/2024/12/leverage-in-non-bank-financial-intermediation-consultation-report/.

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evaluate the current state of the market and what, if any, changes might need to be made.[3] The timing of the Report is also surprising given that it comes *after* the review and amendment of relevant rules in both the U.S. and the EU.[4]

The FSB invokes an array of well-trodden examples to make its case that non-banks, and in particular hedge funds and other investment funds, pose a particular risk to financial stability. This is not the case and the events being cited do not support this assertion. It would be beneficial if, given the already high level of available data, the FSB could carry out a more detailed analysis on, for example, leverage levels and performance of funds to start drawing at least some rudimentary systematic conclusions about the extent to which leverage as a factor does play a role in increasing risk in strategies that use relatively higher levels of it rather than trying to fit anecdotal evidence to theoretical hypotheses.

March 2020 U.S. Treasury sell-off

Hedge funds were by no means the largest sellers of U.S. Treasuries in March 2020, representing a small portion of the overall UST sales during the examined period of stress. U.S. Federal Reserve data shows that while they were significant actors in 2020 other entities, none of whom use leverage, were larger sellers in both dollar amounts as well as the proportion of their own portfolios.[5] The paper that provides probably the most forensic examination of the 2020 March episode states:

> "Our findings are inconsistent with massive hedge fund deleveraging driving the Treasury sell-off. Hedge fund leverage ratios remained largely unchanged. Borrowing levels and collateral rates on repurchase agreements—the primary source of financing for hedge fund UST holdings and sovereign bond basis trades—remained largely unchanged, indicating that funding constraints were not the primary reason for the decline in hedge funds' Treasury exposures."[6]

The paper further notes that hedge funds sales were largely discretionary, driven by liquidity risk management concerns, rather than forced deleveraging. They responded to market stress by reducing risky positions, increasing liquidity, and adjusting arbitrage trades, rather than liquidating due to margin constraints or financing withdrawals. The stability of hedge fund leverage ratios throughout the turmoil suggests that, while their selling contributed to market dislocations at the margins, it was not the primary cause or amplification factor of the Treasury market stress in March 2020. In other words, the March 2020 UST market disruption would, in all likelihood, occur even without any presence of hedge funds in the market.

3 *See* the SEC rule on Risk Management and Resilience of Covered Clearing Agencies with the revised compliance dates, at https://www.sec.gov/files/rules/final/2025/34-102487.pdf.

4 *See* amendments to the U.S. Securities and Exchange Commission's ("SEC") private fund reporting requirements discussed at https://www.sec.gov/newsroom/press-releases/2024-17 and amendments to the EU Alternative Investment Fund Managers Directive ("AIFMD") discussed at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L_202400927.

5 *See* the Federal Reserve FEDS Notes October 2021 article, "Sizing hedge funds' Treasury market activities and holdings", which notes: "Hedge fund selling of Treasury securities in Q1 2020, though large, was not outsized compared to the selling by other types of investors", at The Fed - Sizing hedge funds' Treasury market activities and holdings.

6 *See* LTCM Redux? Hedge Fund Treasury Trading and Funding Fragility during the COVID-19 Crisis (June 2021), at Sumudu-Watugala-HF_Treasury_Shock.pdf.

Bank of England scenario testing finds low margin calls for hedge funds

Pension funds, LDI ("Liability Driven Investment") funds and insurers would have been subject to £92 billion in margin calls under the Bank of England's recent system-wide exploratory scenario exercise ("SWES").[7] We note that further policy measures have been put in place for LDI funds.[8] This compares with margin calls of just £2 billion for hedge funds. This underlines our contention that hedge funds do not present systemic risks to the financial system and that far more nuance over the term "NBFI" is needed. In particular, the SWES scenario points to a heterogeneous response by the hedge fund industry to the modelled shock, alleviating concerns about potential concentration or herding risks in the industry.

Archegos

As is often the case, the experience of the Archegos *family office* (i.e., not a fund/fund manager) is used as an example of how leverage is in some way hidden or not accessible.[9] This was not the case as Credit Suisse, the bank most affected by the saga, made clear in the report its board commissioned to investigate the episode.[10] Rather, there was a risk management failure as Credit Suisse neglected to enforce the margin calls prescribed by its risk department. In either event, it is not clear that the Archegos failure posed a systemic risk to the wider financial system. Moreover, Archegos should not be held up as an example of the lack of regulation of hedge funds given that it was not one. Family offices are regulated differently from funds and fund managers.

Take a holistic view of risks

This work needs to assess all sources of potential risks, regardless of the type of institution they may emanate from. For example, the behaviour of banks can be to the detriment of the wider market and harm their counterparties. For example, a recent European Central Bank ("ECB") report notes that banking regulations can be subject to manipulation in a way that may harm the wider market.[11] The Bank of England's SWES demonstrates that counterparties such as hedge funds cannot always rely on banks to extend repo facilities in times of stress.[12]

Clarify the scope

The Report identifies insurance companies, pension funds, broker-dealers, some banks, as well as hedge funds and other leveraged investment funds as in its scope.[13] The Report would benefit from greater

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7 *See* paragraph 2.1 of the SWES, available at The Bank of England's system-wide exploratory scenario exercise final report | Bank of England.

8 See the Bank of England's recommendations, available at https://www.bankofengland.co.uk/financial-policy-summary-and-record/2023/bank-staff-paper-ldi-minimum-resilience.

9 *See* the Report, *supra* note 2, at 7, section 2.3. Role of NBFI leverage during recent episodes of stress.

10 Report of Paul, Weiss, Rifkind, Wharton & Garrison LLP, "Credit Suisse Special Committee of the Board of Directors Report on Archegos Capital Management" (29 July 2021), available at https://www.paulweiss.com/practices/litigation/internal-investigations/news/credit-suisse-publishes-independent-review-of-archegos-losses?id=40637.

11 *See* ECB Working Paper Series No. 3016, "Leverage actually: the impact on banks' borrowing costs in euro area money markets" (2025), at page 2, available at https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp3016~c0bef6e424.en.pdf?b912233fa89cb2bec28aca944945e7d3

12 *See* Box B: Hedge funds and repo from the SWES final report.

13 Background on page I of the Report, *supra* note 2.

precision as to how the recommendations and details are expected to apply to such a divergent range of business models.

Include banks in scope as major providers and users of leverage

Much of the debate on leverage appears to be motivated by the mitigation of perceived risks by non-banks to banks. A characteristic of this debate has been to focus on the risks that non-banks may pose to the banks who facilitate their leverage. A discussion of whether banks' appetite for facilitating leverage or whether the rules governing their ability to do so are appropriate has been absent. As we discuss in our reply to question 20, a bank that reports a leverage ratio of little over 20 under the EU Capital Requirements Regulation 2 rules, would report a leverage ratio of over 300 if it used the same method as required for hedge funds under the EU AIFMD.

It is therefore interesting that there appears to be an extremely high level of tolerance for leverage in one sector of the financial market but serious concern about the sector that, according to most metrics, operates with much lower levels of leverage and liquidity mismatches. In other words, if leverage is a problem in the system, it should be first and foremost addressed in a consistent manner. Entities presenting high levels of directional leverage, asset illiquidity and short-term liabilities should most likely be under the highest level of scrutiny by the policy making community. Hedge fund managers generally exhibit none of these characteristics.

Re-examine the effectiveness of current metrics

The leverage metrics currently employed are, as we discuss below, inadequate for risk management purposes as they are not sufficiently sensitive to the varying uses of derivatives. For hedge funds, more meaningful metrics arise when issues relating to margin combined with long and short positions are combined.

Avoid emotive and misleading language

AIMA is also concerned at the use of emotive and misleading terms such as "hidden" leverage. In the context of hedge funds and other alternative investment or private funds it is hard to understand what is meant by "hidden" leverage. Since the Global Financial Crisis ("GFC"), major asset management jurisdictions have put in place extensive regulations relating to the management and reporting of leverage and the counterparties involved in it.

Acknowledge relevant previous work

There is scant reference to the very considerable amount of work which has been carried out by the International Organization of Securities Commissions ("IOSCO") at the instruction of the FSB to create more uniform definitions of leverage in investment funds, have it reported to national regulators then and publish global aggregate figures annually.[14]

[14] *See* the recommendations in the 2017 FSB SCAV Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities, available at https://www.fsb.org/2017/01/policy-recommendations-to-address-structural-vulnerabilities-from-asset-management-activities/.

Encourage making better use of existing data

A comprehensive and often complex set of regulatory requirements has been developed since the GFC. This has often been done on a sector-by-sector basis, varying between regions and jurisdictions and is often overlapping and duplicative.[15] As the Credit Suisse report into Archegos noted, the information on the risks was available, the issue was not access to data but the unwillingness of the bank's employees to take account of it. More analysis is needed on how cases such as Archegos could be prevented using tools and data that regulators and banks already have before creating further requirements.

There is also a delicate balance between transparency and risk management. The regulatory demand for more data should be balanced with the impact it will have to the hedge fund industry, especially at a time when the power to use and abuse such data through developments in AI could have serious implications.

Therefore, the question is not whether data is available to allow for the proper identification and management of risk, but whether firms make use of that information and are supervisory authorities ensuring they do. However, we identify some areas where reporting could be amended to improve the data currently available in our response to at the Report's question 5.

Private disclosure

Private disclosure of data between counterparties is important as it allows for an assessment of risk before and during a relationship. This information is by its nature often non-standard and is often commercially or market sensitive. We do not see any justification for the FSB's recommendation to provide wide-ranging aggregate data to counterparties.[16] It would be burdensome, highly subjective, as well as potentially forcing unwarranted disclosures which could be market sensitive or increase the risk of market manipulation.

Minimum disclosure requirements can also create barriers to entry. We do, however, welcome the Report's recognition that proprietary client information should remain confidential.[17]

Notwithstanding the issues we raise above, AIMA welcomes the FSB's recognition that any such further work is best done at jurisdictional level. This recognises that various jurisdictions already have rules in place which they may or may not see the need to recalibrate in light of the conclusions of this Report. On that basis we do not see the need for the FSB or other standard setting boards to develop yet further guidance for them.[18]

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15 For example, the EU and UK Markets in Financial Instruments Regulation trade and transaction rules effectively require double reporting of the same data, Article 26 of MiFIR (Obligation to Report Transactions), and Articles 14-23 of MiFIR, available at https://www.legislation.gov.uk/eur/2014/600/article/26.

16 *See* the Report, *supra* note 2, at 27 ("Clients should provide aggregate information on their exposures across all entities or vehicles that are managed under a common strategy or decision-making process, to capture the impact of a coordinated liquidation across the client's full range of related investment products or vehicles.").

17 *See id.* at 28, paragraph 2.

18 *See id.* at 1, paragraph 5.

We would be happy to elaborate further on any of the points raised in this response. For further information, please contact James Hopegood, Director of Asset Management Regulation and Sound Practices (jhopegood@aima.org).

Yours faithfully,

Jiří Król
Deputy CEO
Global Head of Government Affairs

ANNEX

AIMA's responses are below. Where we do not respond to a question, we delete it. However, the original numbering of the questions remains for ease of reference.

Recommendation 1

1. Is the description of the financial stability risks from leverage in NBFI accurate and comprehensive? Are there additional vulnerabilities or risk dimensions related to NBFI leverage that authorities should consider for monitoring purposes?

The way in which this debate has been framed gives the false impression risk is a "one way street" from non-banks to banks. The reality is far more complex and shows that counterparty relationships are dynamic and have the potential to transmit risks in both directions. As we discuss in the covering letter, analysis of the Archegos event as well as recent analysis by central banks including the ECB and Bank of England demonstrate that banking regulations are open to manipulation and that in times of stress key facilities such as repo may be restricted or not extended further by banks.

The Credit Suisse report states:

> "The Archegos default exposed several significant deficiencies in [Credit Suisse's] risk culture, revealing a Prime Services business with a lackadaisical attitude towards risk and risk discipline; a lack of accountability for risk failures; risk systems that identified acute risks, which were systematically ignored by business and risk personnel; and a cultural unwillingness to engage in challenging discussions or to escalate matters posing grave economic and reputational risk. The Archegos matter directly calls into question the competence of the business and risk personnel *who had all the information necessary to appreciate the magnitude and urgency of the Archegos risks, but failed at multiple junctures to take decisive and urgent action to address them*."[19] (Emphasis added)

Given this, the debate should take the widest possible look at how leverage is deployed and the way in which financial institutions account for it. Separating bank from non-bank uses of leverage is unhelpful and misleading. The current debate has tended to see banks portrayed as providers of leverage and the discussion has centred on the risks they face from the institutions they lend to. The reality is that banks are extensive users of leverage and are subject to a range of requirements, some of which are capable of manipulation to the detriment of the wider market. The February 2025 ECB report entitled "Leverage actually: the impact on banks' borrowing costs in euro area money markets", notes in relation to the loan ratio ("LR") rule in bank leverage requirements:

> "… the LR requirement reduces banks' willingness to hold reserves, particularly (but not only) on reporting dates, typically at quarter- and year-ends. Around these days banks tend to "window-dress" their balance sheets by shrinking their reserve holdings. They do so by temporarily reducing overnight money market borrowing, which pushes money market rates down and manifests in sharp downward spikes in rates. This may cause volatility in demand for reserves at reporting dates and a widening of the spread between short-term

19 *See* the Credit Suisse report at *supra* note 9.

money market rates and the ECB's deposit facility rate, with potential implications for monetary transmission."[20]

Further, a key finding from the recent Bank of England SWES is that banks are likely to be unwilling to provide additional repo financing or will impose tighter terms on non-banks that have existing repo agreements with them. Banks pose a particular threat to hedge funds in this regard.[21]

The use of the term NBFI is also confusing in this context as the FSB includes some banks in its scope. A better and clearer definition of what constitutes an NBFI and how they may be connected would improve the quality of the debate. The assumption, for example, that all alternative investment funds are leveraged is untrue. Similarly, insurers and pension funds vary widely in their forms and business.

2. What are the most effective risk metrics that should be considered by authorities to identify and monitor financial stability risks arising from NBFI leverage?

The Report sets out a range of risk metrics for NBFI to consider.[22] The leverage metrics reflect the IOSCO 2019 Final Report on Recommendations for Assessing Leverage in Investment Funds.[23] AIMA has a long-standing concern that those leverage metrics do not provide a meaningful picture of leverage employed by investment funds.[24] Even where adjustments are made, we are concerned that they are too crude to reflect properly the use of derivatives for hedging purposes and so systematically overstate the amount of leverage employed. They are therefore a poor indicator for risk management purposes.

More meaningful risk management information could be gleaned by using data on initial margins ratios and initial margins to cash or highly liquid assets which are discussed by the Report.[25] This data can be for both cash and synthetic instruments. But this will only give meaningful information if it is combined with data on both long and short positions.[26]

This current iteration of the debate on leverage and the shortcomings to the leverage metrics we refer to have their beginning in January 2017 with the FSB standing committee on assessment of vulnerabilities ("SCAV") report, Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities.[27]

The 2017 report instructed IOSCO to develop risk-sensitive measures to assess and monitor leverage in investment funds for financial stability purposes.[28] It also instructed IOSCO to collect aggregate data from

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20 *See* The ECB Working Paper at *supra* note 10.

21 *See* Box B: Hedge funds and repo from the SWES final report, available at https://www.bankofengland.co.uk/financial-stability/boe-system-wide-exploratory-scenario-exercise/boe-swes-exercise-final-report.

22 *See* the Report, *supra* note 2, at 33, Annex 1.

23 *See* the IOSCO report available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD645.pdf.

24 *See* AIMA's response to the IOSCO leverage consultation available at https://www.iosco.org/library/pubdocs/615/pdf/MFA%20-%20AIMA%20-%20ACC.pdf.

25 *See* the Report, *supra* note 2, at 34.

26 This data is already collected. *See, e.g.,* the SEC Form PF Section 2A, Item A. Exposure of hedge fund assets, available at https://www.sec.gov/files/formpf.pdf.

27 Id. 2017 FSB SCAV Policy Recommendations at footnote 13.

28 *See* Recommendation 10: IOSCO should identify and/or develop consistent measures of leverage in funds to facilitate more meaningful monitoring of leverage for financial stability purposes, and help enable direct comparisons across funds and at a global level. IOSCO should also consider identifying and/or developing more risk-based measure(s) to complement the initial

its member jurisdictions based on those measures to enable global monitoring of leverage in funds.[29] In order to do this, as well as monitor risks, the FSB instructed individual jurisdictions' relevant authorities to collect that data.[30]

Given that the FSB has effectively mandated a global system of leverage data collection and aggregation, it is surprising that the Report makes only passing reference to the IOSCO work which put the framework the FSB mandated into place.[31] Nor does the Report mention the now annual IOSCO Investment Funds Statistics Report which provides the aggregated data requested by the FSB in 2017.[32]

As a result, it is not clear if the FSB wants jurisdictions to ensure they have implemented the IOSCO recommendations, for example, or whether it sees the recommendations as in some way inadequate and wants them to be revised on a jurisdiction-by-jurisdiction basis.

We have no comments on the leverage metrics used by insurance companies and pension funds.

3. What are the most effective metrics for the monitoring of financial stability risks resulting from

(i) specific market activities, such as trading and investing in repos and derivatives?

(ii) specific types of entities, such as hedge funds, other leveraged investment funds, insurance companies and pension funds?

(iii) concentration and crowded trading strategies?

As we have discussed, banks and infrastructure providers have an important role. Top tier banks/brokers/clearers should have a clear view of such activities through their margining system. Most banks are now using margin systems based on stress tests, and some apply a multiplier to exchange margins where they see that the exchange's risk pricing is too low.

Recommendation 3

4. What types of publicly disclosed information (e.g. transaction volumes, outstanding amounts, aggregated regulatory data) are useful for market participants to enhance their liquidity or counterparty credit risk management?

Are there trade-offs in publicly disclosing such information and, if so, what would be the most important elements to consider?

What is the appropriate publication frequency and level of aggregation of publicly disclosed information?

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measures with a view to enhance authorities' understanding and monitoring of risks that leverage in funds may create. In both cases, IOSCO should give consideration to appropriate netting and hedging assumptions and where relevant build on existing measures.

29 *See* Recommendation 12: IOSCO should collect national/regional aggregated data on leverage across its member jurisdictions based on the consistent measures it develops.

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

31 *See* the Report, *supra* note 2, at 18, Section 4.1.

32 *See* the 2024 Investment Funds Statistics Report, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD761.pdf.

We question how useful public disclosure of such data would be and what further disclosure would achieve. As we have already noted, following the FSB's instructions in 2017, IOSCO now publishes its annual Investment Funds Statistics Report which provides aggregated data. AIMA encourages better data sharing between regulatory authorities as our view is that sufficient data is already available to monitor the possible risks the FSB is concerned about, but they would benefit from being better organised and made available in a coherent manner. A well-established international framework, the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMoU), is already in place.[33] Currently 130 securities regulators are signatories to it.[34] We encourage further analysis of how this can be better used.

We repeat our concern that where data is publicly disclosed care needs to be taken to ensure that market sensitive or proprietary data is not made available to the marketplace. Improper or systematic disclosure of such information could allow for market manipulation as well as being commercially damaging to the firms affected.

Recommendation 5

5. Do Recommendations 4 and 5 sufficiently capture measures that would be used to address the scope of non-bank financial entities under consideration in this report?

In what ways may the policy measures proposed in the consultation report need to be adjusted to account for different types of non-bank financial entities?

Please see our responses to question 1 and 10. The Report's extremely wide and somewhat vague scope means it is hard to understand what all the risks are that it wishes to capture. The lack of a meaningful analysis of the different types and sub-types of NBFI that exist drives this lack of clarity. Hedge funds have robust internal governance processes and controls to ensure that any leverage they employ is done in conformity with both the limits set out in individual offering documents as well as applicable local rules.

AIMA believes that some amendments could be made to make the data already being reported more meaningful. We discuss this further in our response to question 10.

However, we do not accept that further entity-based measures are needed as we also further describe in our response to question 10.

6. In what circumstances can activity-based measures, such as

(i) minimum haircuts in securities financing transactions, including government bond repos,

(ii) enhanced margin requirements between non-bank financial entities and their derivatives counterparties, or

(iii) central clearing, be effective in addressing financial stability risks related to NBFI leverage in core financial markets, including government bond markets?

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[33] For details, see https://www.iosco.org/v2/about/?subsection=mmou.

[34] For the full list, see the link to the list at https://www.iosco.org/v2/about/?subsection=mmou.

To what extent can these three types of policy measures complement each other?

Haircuts applied to securities financing transactions restrict the extent of borrowing capacity and effectively limit the extent of leverage by reducing the amount of cash or securities that can be borrowed relative to the collateral's value. However, the level of haircut imposed should vary depending on the credit rating of the government issuer, the liquidity and depth of that particular bond's market, and its maturity profile. Similarly, margin requirements, when properly established by credit and market conditions, control the extent of risk exposure and limit the extent of leverage. Central clearing requirements require the use of a central clearing counterparty, who have an incentive to implement initial and variation margin requirements based on market risk to protect the clearinghouse. Combining all three measures helps ensure more consistent haircut and margin practices, limits leverage in bond and repo markets and reduces procyclicality during periods of market stress.

Thus, an extension of central clearing to a broader range of financial instruments than at present could be beneficial as long as the margin and collateral haircut requirements as well as netting arrangements are appropriately market risk-based. However, repo markets, which are key providers of market liquidity, could be adversely affected by central clearing if margin requirements result in scarcity of high-quality collateral, if clearing fees and compliance costs reduce market participation, reduced flexibility or if other requirements result in market dislocations due to less liquidity and/or increased volatility.

The U.S. is currently implementing changes that will require greater use of central clearing. As these new rules are implemented they will provide more information on how well mandatory central clearing will work in practice and the advantages and disadvantages it may bring. This will bring more insight into how this finely balanced debate could progress. Other areas of further work could include:

- Addressing the pro-cyclicality inherent in central clearing by improving central counterparties' resilience;
- Implementation of the recent BCBS-CPMI-IOSCO recommendations and new EU rules on CCP margin model transparency;[35] and
- Expanding the forms of collateral available to meet initial margin requirements for cleared derivatives and initial and variation margin for uncleared derivatives.

7. Are there benefits to dynamic approaches to minimum margin and haircut requirements, e.g. where the requirements change based on changes in concentration or system-wide leverage?

If so, what types of indicators capturing concentration or system-wide leverage should the requirements be linked to?

Setting supervisory minima for haircuts would be fraught and very difficult in a way that does not create further risks. For example, haircuts would vary greatly between different jurisdictions' sovereign bonds which would make any kind of standardisation very difficult to achieve. We do not believe this would be a useful policy choice.

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[35] *See* the BCBS-CPMI-IOSCO recommendations, available at https://www.bis.org/bcbs/publ/d590.htm, and the EU EMIR Article 38, Transparency, available at https://www.esma.europa.eu/publications-and-data/interactive-single-rulebook/emir/article-38-transparency#:~:text=A%20CCP%20shall%20disclose%20to,exposures%20to%20its%20clearing%20members.

Margin and collateral calls have been the subject of a great deal of regulatory scrutiny over the last year with a wide-ranging consultation from the FSB on it.[36] The FSB made a range of recommendations to market participants. They should be given time to analyse and if necessary amend their practices and assess the effect before further work is done.

In addition, banks have different approaches to their risk management practices and having that diversity is a positive feature. Imposing minimum/haircuts could have unintended consequences in terms of disrupting that diversity and also cause a race to the bottom as a minimum margin requirement may not be sufficient for certain trading strategies.

8. Are there any potential unintended consequences from activity-based measures beyond those identified in the consultation report?

Activity-based measures may not account for the netting practices across multiple products that many hedge funds employ and that the banks already risk manage by setting dynamic margin requirements on the hedge funds overall book.

9. For non-centrally cleared securities financing transactions, including government bond repos, what are the merits of margin requirements compared to minimum haircuts?

Banks establish margin requirements based on our overall portfolio. Imposing either margin requirements or minimum haircuts would disrupt existing margining practices and could impact the viability of certain existing trading strategies that employ the heavy use of leverage while being very low risk.

10. In what circumstances can entity-based measures, such as

(i) direct and

(ii) indirect leverage limits be effective in addressing financial stability risks related to NBFI leverage in core financial markets?

While we agree that leverage providers should adequately limit the amount of leverage that they provide to clients and that the level of leverage may and, in many cases, should depend on the amount of private disclosure that the client has provided. However, this leverage level setting should be done by the leverage providers and not imposed by regulators.

There are a number of factors that banks consider when determining the appropriate amount of leverage and disclosure required for its clients. What should be required from a 20 year old hedge fund that has a low risk market neutral book should be different from what is required from a newly-formed entity that trades more directionally (or which has lower accountability to investors, for example, because it is a family office). Banks are in a better position to risk manage each individual client in a dynamic manner that aligns with their risk management practice. It should be the focus of regulators to monitor banks to ensure that each bank it regulates has sound risk management practices that are seen to be implemented and do not

[36] *See* the FSB Liquidity Preparedness for Margin and Collateral Calls: Final report, available at https://www.fsb.org/2024/12/liquidity-preparedness-for-margin-and-collateral-calls-final-report/.

impose additional burden and costs on banks and their clients, which may have unknown and unintended consequences on the proper functioning and efficiency of the market.

On that basis we do not believe top down regulatory leverage limits should be imposed, particularly for investment funds offered to institutional or professional investors. They are a crude measure which may ultimately be counterproductive from a financial stability perspective. The requirement for AIFMs to set a limit a maximum as defined under AIFMD already is onerous and has the ability to create perverse outcomes.

For example, as we discuss in our response to question 2, the current calculation methodologies can dramatically overstate the amount of leverage in funds. Imposing a limit will mean that funds using derivatives for hedging purposes will find their ability to do so curtailed as the metric used to fix the limit is flawed in that it makes no distinction between derivatives use for hedging (i.e., risk reduction) and derivatives use for directional exposure (i.e., risk taking).

The investment fund sector is highly dispersed with no one single set of "super funds" that concentrate risk in the way that major banks do. We also note that the use of leverage is subject to a range of controls and limits set out in individual offering documents as well as in terms of governance and collateralisation and margin requirements. We commend the Monetary Authority of Singapore's ("MAS") clear approach, which is: "A single hedge fund may be leveraged to the extent disclosed in the prospectus."[37]

11. Are there ways to design and calibrate entity-based measures to increase their risk sensitivity and/or their effectiveness in addressing financial stability risks from NBFI leverage?

Banks should calibrate the leverage limit they impose on clients based on various factors: a regulatory "bucketing" of clients into different categories would create inefficiencies and lead to potentially negative outcomes for both the bank and their client.

Recommendation 6

14. How could counterparty credit risk management requirements for leverage providers be enhanced to be more effective in addressing financial stability risks from NBFI leverage in core financial markets, such as government bond repo markets?

In what circumstances can they be most effective?

enhanced to be more effective in addressing financial stability risks from NBFI leverage in core financial markets, such as government bond repo markets? In what circumstances can they be most effective?

This is a very broad question. A key issue for financial markets in times of stress is access to adequate liquidity. In this respect, more focus on ensuring that liquidity providers such as banks are resilient and able to provide this essential service would yield more practical results, such as being better able to maintain repo market facilities, rather than another review of non-bank rules.

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[37] *See* MAS Code on Collective Investment Schemes. Appendix 3, Investment Hedge Funds, rule 4.8, available at, https://www.mas.gov.sg/-/media/mas/regulations-and-financial-stability/regulations-guidance-and-licensing/securities-futures-and-fund-management/regulations-guidance-and-licensing/codes/cis-code-last-revised-28-nov-2024.pdf.

Additionally, current risk management practices vary amongst leverage providers so efforts by national regulators to promote a principles-based approach to ensuring all leverage providers are meeting "best practices" could enhance financial stability.

Recommendation 7

15. Would a minimum set of disclosures to be provided by leverage users to leverage providers be beneficial in improving counterparty credit risk management and reducing financial stability risks from NBFI leverage, including concentration risks? If so, which in this minimum set and why?

No, further disclosure other than that which is already standard practice across jurisdictions would not be beneficial. Leverage takes many forms and, as we have already discussed, the use of derivatives for hedging purposes is often incorrectly bucketed in with it. Further standardised requirements risk repeating the besetting sins of the inflexible and crude leverage metrics that resulted from the FSB's 2017 instructions to IOSCO.[38]

The often non-standard data required by leverage users and providers to make fully informed decisions is already provided for in offering documents that set out whether leverage may be used by a fund and if, so the parameters for its use, the risk management that firms should have in place and the extensive due diligence work the firms involved in providing or using leverage will carry out.

The types, levels and frequency of disclosures that a leverage provider should require from its clients should be determined by the leverage provider based on its risk assessment of the client, which in turn should be based on a variety of factors such as the client's trading strategy and portfolio of assets, the client's existing public disclosures, the way the client is margined and how much leverage it uses.

We also note that minimum disclosure requirements will create an additional barrier to entry for new leverage providers in an already heavily top-weight environment and likely incentivise a race to the bottom. Banks need to be adequately supervised and more focus should be made by regulators to determine how to ensure that banks have robust risk management policies and procedures and are adhering to those standards.

16. What are the main impediments that leverage users face in sharing additional or more granular data with their leverage providers?

Is there a risk that a minimum recommended set of disclosures may lead leverage users to limit the information they share with their leverage providers to that minimum set?

Leverage providers will have in place very thorough risk management systems, and they already request periodic reports from leverage users. However, this exchange is triggered through the leverage providers' internal assessments/flags. It would be very taxing and cumbersome for all leverage users to adhere to a blanket set of disclosures, irrespective of the extent of leverage used and the assessment of the leverage provider itself. Further, not all entities are structured the same way and requiring uniform disclosures may create a burden on certain types of structuring and cause unintended consequences.

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[38] *See* the FSB Report at *supra* note 11.

17. Should such a minimum set of disclosures rely on harmonised data and metrics to ensure transparency and efficiency in the use of such information for risk management purposes?

Do respondents agree that such a minimum set of disclosures should be based on the list of principles outlined in the consultation report? If not, which principles should be added, deleted, or amended?

Please see our response to question 16.

18. Should leverage users be required or expected to provide enhanced disclosures (beyond that provided in normal market conditions) to their leverage providers during times of stress?

In the fund context, this should already be accounted for as part of routine stress testing processes. We would expect all counterparties to be in contact with each other during times of financial stress. We do not believe there is a need for further rules to facilitate already well-established governance and risk management practices which firms will have in place for practical, commercial reasons.

Margining systems now incorporate elements of stress testing. Leverage providers will usually have full access of the products held by the leverage user, so they already have the ability to run stress tests using those parameters.

Any requirement to provide enhanced disclosures should be negotiated and agreed between the relevant leverage providers and users. Requiring a minimum set of enhanced disclosures during times of stress would increase the burden on both leverage providers and leverage users when the market stress may not be applicable based on the trading strategy / assets of the leverage user. Requiring enhanced disclosures may be warranted for certain leverage users based on a variety of factors (including, without limitation, how the leverage provider risk manages the relevant client on a business as usual basis, the client's track record, etc.), but it should be up to the leverage provider to make the determination based on its risk management determinations and not applied in a one-size fits all approach through the imposition of a regulatory requirement. National regulators can assist in this process by employing principles-based approaches to best practices.

19. Should authorities design a minimum set of harmonised disclosures and guidelines on its application, or should they convene a cross-industry working group to do so?

How do respondents believe such a standard should be incorporated into market practice? Through regulation, supervisory guidance, and/or via a Code of Conduct or similar approach?

Please see our response to question 18.

Recommendation 8

20. Are there areas where the principle of "same risk, same regulatory treatment" should be more consistently applied? Are there circumstances in which the principle should not apply or should not apply comprehensively?

The way in which leverage is assessed varies greatly sector by sector and prevents a meaningful analysis of how it is spread between different types of financial entities. When analysed on a "like-for-like" basis, banks are far more leveraged than hedge funds. This leads us to conclude that "same risk, same regulatory treatment" either means should banks have their leverage assessed in the same way as hedge funds do, or hedge fund leverage should be assessed in a way similar to that required by bank regulations.

We discussed this issue at length in our response to the European Commission consultation on Assessing the Adequacy of Macroprudential Policies for Non-Bank Financial Intermediation in November 2024.[39] We have reproduced the relevant section below for ease of reference:

> "Measurements of leverage in OEFs are less sophisticated than those used by banks. Both allow for netting and hedging, that is, where holdings of one asset offset the risk of another or when derivatives are used to reduce or manage risks. But the rules for hedge funds and other investment funds do not incorporate a wide range of adjustments to reduce the impact of certain types of derivatives on the overall measurements of leverage. Banks by contrast can use risk-sensitive 'add-ons' which reduce the impact of derivative exposes in their leverage measurements.
>
> "The ability of banks to apply these add-ons has led to a distorted picture of concentrations of leverage in the financial system. For example, banks make add-ons available for holdings in interest rate derivatives, FX derivatives, credit derivatives, equity derivatives and commodity derivatives. The Basle II methodology allows offsetting of up to 40% for commodity derivatives. It can be up to 10% for credit derivatives and for interest rate derivatives, up to 1.5%.[40]
>
> "In contrast, investment funds are largely confined to netting positions and hedging, subject to strict matching rules. For example, one large Global Systemically Important Bank ("G-SIB"), in its 2023 full year results, states that it has a leverage ratio of 4.6% at the end of 2023 as calculated in accordance with the Capital Requirements Regulation 2 ("CRR2"). Expressing this differently (as an equity multiplier), the bank is therefore approximately 20x levered. However, were the G-SIB's leverage to be calculated as if it was as hedge fund using the gross notional exposure ("GNE") methodology under the AIFMD, a very different picture emerges.
>
> "The G-SIB's balance sheet of €2.5 trillion can be used as a proxy for an investment fund's gross assets under management ("GAUM"). It then has an off-balance sheet exposure of €34.6 trillion and its tier 1 capital, a proxy for an investment fund's net asset value ("NAV") is €123 billion.

On these figures, the G-SIB's GNE calculation under an approximation of the AIFMD requirements would have been: (Balance sheet + off-balance sheet exposure) divided by the tier 1 capital (€2.5 trillion + €34.6 trillion)/€123 billion = 301.6

[39] Full AIMA response available at https://finance.ec.europa.eu/regulation-and-supervision/consultations-0/targeted-consultation-assessing-adequacy-macroprudential-policies-non-bank-financial-intermediation_en.

[40] *See* Bank for International Settlements, CRE52 – Standard approach to counterparty credit risk, available at https://www.bis.org/basel_framework/chapter/CRE/52.htm.

"This figure of 301.6x leverage (expressed in percentage terms this is over 30,000% of equity) is thus ten times higher than the 'regulatory' leverage measure for banks which dramatically deflates off balance sheet derivatives exposures. This is significantly higher than the 90th percentile of most leveraged hedge funds, using a similar methodology as Figure 1 below shows. So, when hedge funds' and banks' leverage is compared using the same methodology we see that banks are exposed to potentially much more leverage than hedge funds, yet their balance sheet is more illiquid and more at risk of runs. As we discuss in the covering letter, we do not see how leverage in alternative investment funds can be described as 'hidden' given the thorough-going and extensive reporting requirements set out in AIFMD Annex IV.

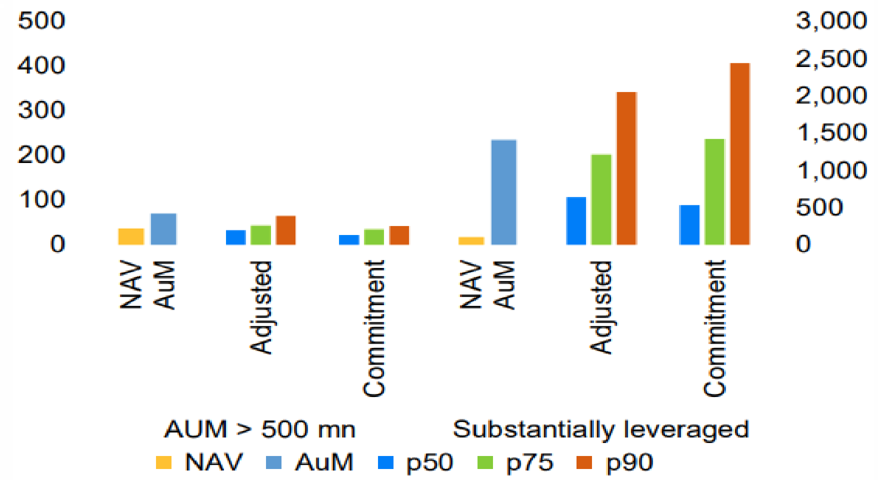
"This amply demonstrates that epithets such as 'excessive' or 'hidden' cannot be meaningfully applied to leverage in investment funds when compared with the banking sector as levels of leverage of higher magnitude supported by a more fragile balance sheet are deemed to be acceptable in the banking sector."

Figure 1[41]

Chart 4

HF leverage

Highest level of leverage across fund categories



Note: NAV and AuM of EU AIFs using leverage on a substantial basis and leveraged AIFs managing more than EUR 500mn, in EUR bn (LHS); leverage measured by the adjusted method and the commitment method, for the median, the 75percentile and the 90 percentile, in % (rhs). Data for the EEA30, in 2022.
Sources: AIFMD database, National Competent Authorities, ESMA.

[41] Originally published in the European Securities and Markets Authority 30 January 2024 TRV Risk Analysis, Assessing risks posed by leveraged AIFs in the EU, page 7, available at, https://www.esma.europa.eu/sites/default/files/2024-01/ESMA60-1389274163-2572_TRV_article_-_Assessing_risks_posed_by_leveraged_AIFs_in_the_EU.pdf.