Associação Brasileira das Entidades
dos Mercados Financeiro e de Capitais

ANBIMA

São Paulo, 21 September 2016

Secretariat of the Financial Stability Board
Via email: fsb@fsb.org

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

Dear Sirs and Madams,

Please find enclosed to this letter a copy of the reply from the **Brazilian Financial and Capital Markets Association (ANBIMA)** to the questions posed by the Consultative Document "*Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities*". The Association appreciates the opportunity given by the Financial Stability Board to comment on potential risks, existing mitigants and policy proposals associated to a range of asset management activities.

To address the questions posed by the Consultative Document, our reply presents many specific features of the local market that helped pave the way for the sustainable development of the national asset management industry. With these inputs, we expect to illustrate that structural differences in asset management activities across jurisdictions might provide for distinct solutions to the identified risks. It is our understanding that these structural differences should be taken into account when drawing international standards, to allow national authorities to adapt to them accordingly. Relevant in the case of Brazil was the development of a differentiated regulatory regime that, complemented by ANBIMA's Initiatives, allowed for the strengthening of the oversight standards and the soundness of the sector.

ANBIMA looks forward to contributing to further initiatives from the Financial Stability Board with regards to asset management activities and the appropriate tools to monitor and mitigate potential risks. We remain at your disposal to explain in more details some of the information presented in this answer.

Yours Sincerely,

José Carlos Doherty
ANBIMA Chief Executive Officer

Associação Brasileira das Entidades
dos Mercados Financeiro e de Capitais

ANBIMA

São Paulo, 21 September 2016

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

Comments from the Brazilian Financial and Capital Markets Association (ANBIMA)

1. Summary

ANBIMA, the Brazilian Financial and Capital Markets Association, commends the FSB for undertaking the initiative to assess and understand potential financial stability risks associated with the asset management industry. The Consultative Document "Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities" is a relevant step in this direction, by allowing market participants and stakeholders to comment on matters such as the identified risks, existing mitigants and ensuing proposals for addressing residual risks. In this sense, the Brazilian Financial and Capital Markets Association appreciates the opportunity to provide comments on these matters, offering the perspective of our national markets.

An initial difficulty in analyzing asset management activities and products lies in correctly identifying the many structural differences between the regulatory frameworks adopted in different jurisdictions. This diversity has various sources, including, but not limited to, distinct legal structures for the investment vehicles, different attributions for service providers, the stage of development of markets and market infrastructures. It is our understanding that the analysis proposed by the FSB may be at its best when describing the characteristics of central markets, yet it does not appropriately reflect some of the important aspects that also help explain the Brazilian markets' long track record of stability and safety.

With more than USD 850 billion (R$ 3.06 trillion) in Assets under Management, the Brazilian fund management industry has been growing consistently over the last decades and is committed to keep growing on a sound basis. Regulatory and self-regulatory standards are also constantly evolving, according to the needs of this ever advancing market, but maintain some of the core principles that have been laid some decades ago.

Our comments with regards to the identified vulnerabilities, existing mitigants and policy proposals can be summarized as follows:

i. Regarding **liquidity mismatch** in open-ended investment funds, we comprehend that there is no indicator that currently points to new developments in Brazilian markets that might amplify existing vulnerabilities for asset management activities and products if left unaddressed. As the FSB Consultative Document points out: "historical evidence suggests that non-money-market open-ended funds have not created global financial stability concerns in recent periods of stress and heightened volatility". With no recent developments to suggest increased risk, we, therefore, conclude that current policies adopted by Brazilian open-ended investment funds are **adequate for**

the liquidity profile of our national markets. It does not mean that there are no structural issues, the most gaping being the historically low liquidity in **secondary bond markets**.

ii. In general terms, we understand that liquidity management must begin **prior to the constitution of a fund**, by defining target markets for shareholders, objectives, strategies, investment policies and redemption terms and conditions. This is later reinforced by the implementation of adequate **suitability** standards in fund distribution. The definition of **liquidity risk managemen**t policies and procedures provides for an effective mitigant to the risks identified by the FSB. In this aspect, **stress testing** (for the behavior of both assets and liabilities) and **mark-to-market valuation** of funds' assets are paramount.

iii. With regards to **leverage** within investment funds, it is our opinion that two additional principles shall be taken into consideration in the developing of a standardized measures. The first one is that the measure developed by IOSCO should reflect a fund's **exposure to capital risk**, measured as the **maximum potential loss incurred in stressed scenarios**. In our understanding, the maximum potential loss incurred in stressed scenario is the indicator that is most appropriate, in terms of risk, for the classification of the product and for investor disclosure. The second additional principle for is the attention to **margin** (both posted and potential) when elaborating the methodology to measure the above-mentioned exposure to capital risk, since it is both an effective measure for the resources required by a fund to fully liquidate its economic exposure in stressed market conditions *and* a mitigant for counterparty risk. Nevertheless, it is important to note that Brazilian mutual funds register very low leverage, in aggregate, which can be observed through a varied range of metrics.

iv. In relation to the proposals regarding operational risks and **challenges in transferring investment mandates**, it seems advisable that the final policy recommendation on this matter preserves the discretion of the local authority to evaluate to what extent additional requirements to address any residual risk associated with operational risk and challenges in transferring investment mandates or client accounts are in fact necessary. In Brazil, for example, the requirements of an **external custodian** and the responsibilities of the fiduciary administrator (including **due diligence** in hiring and supervising most ancillary services and the possibility that the fund administrator acts as a **transitional manager** if the asset manager has to be replaced) may work as important mitigating factors that are not necessarily considered by the Consultative Document.

v. With regards to **securities lending activities**, we respectfully suggest that policy recommendations also leave each national regulator the authority to decide upon its course of action due to the existence of distinct models for securities lending activities in different jurisdictions. In the case of Brazil, investment funds can only engage in securities lending activities if these are realized through infrastructures authorized by a national regulator. Equity lending activities, more specifically, are only realized via the BTC system, a service provided by BM&FBovespa. These activities are all **CCP guaranteed, cleared and registered**, so that all information regarding these operations is registered and available for the national regulators' appreciation. The residual risks identified by the Consultative Document, in this sense, do not exist in this country.

2. Intro

The Brazilian Financial and Capital Markets Association (ANBIMA) appreciates the opportunity to provide comments on the FSB's Consultative Document on Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities. ANBIMA commends the FSB for undertaking the initiative to understand and address potential vulnerabilities associated with investment management activities, while also allowing for market participants and stakeholders to share their perspectives.

A first important contribution from the FSB ongoing work on asset management lies in its attempt to identify recent trends and, according to these, determine potential structural vulnerabilities and existing mitigants. It is our understanding that this analysis is especially relevant for its potential effect in molding the international community's understanding of the risk channels associated to asset management products and activities worldwide.

Nevertheless, asset management activities and products may vary in both regulatory aspects, according to the development stage of each market. As such, the risks associated to these activities may vary as well. We praise the FSB for conducting this assessment, which attempts to find similarities in a complex and diversified set of products and activities.

Our response focuses specifically on the Brazilian context, assessing to which extent the description of the vulnerabilities identified by the FSB fit the local market. Taking into consideration the characteristics of domestic institutions and markets, we conclude that some of the more specific local features act as effective mitigating factors. Brazil's asset management industry has a long track record of stability, which evidences the quality of domestic regulation, providing for a safe environment for markets to thrive. As we have mentioned on a previous occasion[1], the Brazilian fund management industry has been growing consistently over the last decades and is committed to keep growing on a sound basis. As of the first quarter of 2016, total assets under management (AuM) have surpassed to USD 850 billion (R$ 3.06 trillion)[2]. It is a significant source of financing and an important channel of savings for Brazilian investors. Not only relevant in national terms, the Brazilian Financial and Capital Markets are progressively achieving more prominent roles on regional and global markets.

ANBIMA represents close to 90% of the Brazilian financial and capital markets participants, accounting for more than 290 members, comprising banks, asset managers, fiduciary administrators, brokers, dealers and investment advisers. We are dedicated to the development of stronger capital markets in Brazil and to promote this main goal we provide services to our members and other stakeholders through a range of activities, namely: self-regulation (including supervision and enforcement), representation, professional certification, financial education and the provision of market indicators and industry data. The Association has been taking activities to further reflect the international footprint of our local markets. One important step in this direction was taken in 2005, when ANBIMA joined IOSCO´s Self-Regulatory Organizations Consultative Committee (SROCC, later renamed IOSCO´s Affiliate Members Consultative Committee, AMCC), Committee that the Association has been chairing since 2013.

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[1] ANBIMA (2015). Response to FSB/IOSCO 2nd Consultative Document - Assessment Methodologies for Identifying NBNI G-SIFIs. Available at: http://www.fsb.org/wp-content/uploads/Brazilian-Financial-and-Capital-Markets-Association-ANBIMA.pdf

[2] Data according to ICI worldwide table: https://www.ici.org/info/ww_q1_16_public_report_us.xls.

A second, yet equally important, contribution of the work that is currently conducted by the FSB lies in the definition of policy recommendations. As stated by Mr. Daniel Tarullo[3] these proposals shall provide authorities and asset management entities in different jurisdictions with the tools and data to effectively detect and address the identified risks. In our understanding, this line of work should provide for a positive feedback towards the identification of potential vulnerabilities – which is an always evolving matter.

To contribute to this perspective, our response attempts to stress the relevance of market supervision as a potent regulatory (or self-regulatory) tool to evaluate potential vulnerabilities whose impact on systemic risks may not have already been observed or quantified.

The text is structured as follows: section 3 presents a regulatory framework for Brazil, introducing the main concepts that are later utilized in this document; the ensuing sections present our replies to the Consultative Document's Questions, divided according to the four structural vulnerabilities discussed by the consultation (liquidity mismatch, leverage, operational risk and challenges in transferring mandates and securities lending).

3. Brazilian investment funds: A regulatory primer

Securities regulators have long recognized that Collective Investment Schemes assume different legal forms and structures[4] and their operators have different responsibilities[5] in different jurisdictions. These findings have not stymied their efforts to establish international principles and guidelines to promote convergence in increasingly globalized markets – and IOSCO's ongoing standard setting activities reflect this. The existence of concurring systems has led, however, to the incorporation of such distinctions in the discussions leading to the definition of policy recommendations.

Incorporating this aspect into our response, we present a brief overview of the regulation of Brazil's investment fund and their operators vis-à-vis what is practiced in central jurisdictions. The concepts presented in the following pages will assist the reader in understanding the arguments presented on the latter part of our reply, which addresses the questions posed by the FSB's consultative document.

3.1. Authorities and mandates

The Securities and Exchange Commission of Brazil ("CVM") is the regulatory body responsible for maintaining the sound functioning of the national securities' markets, protecting investors from fraudulent practices, while ensuring that the public has access to adequate and precise information. CVM also supervises the activities and services related to the securities, applying sanctions (fines, warnings, suspensions and temporary disqualifications) as necessary.

The CVM, along the Brazilian Central Bank ("BCB"), are under the oversight of the financial the National Monetary Council ("CMN"), a committee composed by the Minister of Finance, the Minister of Planning

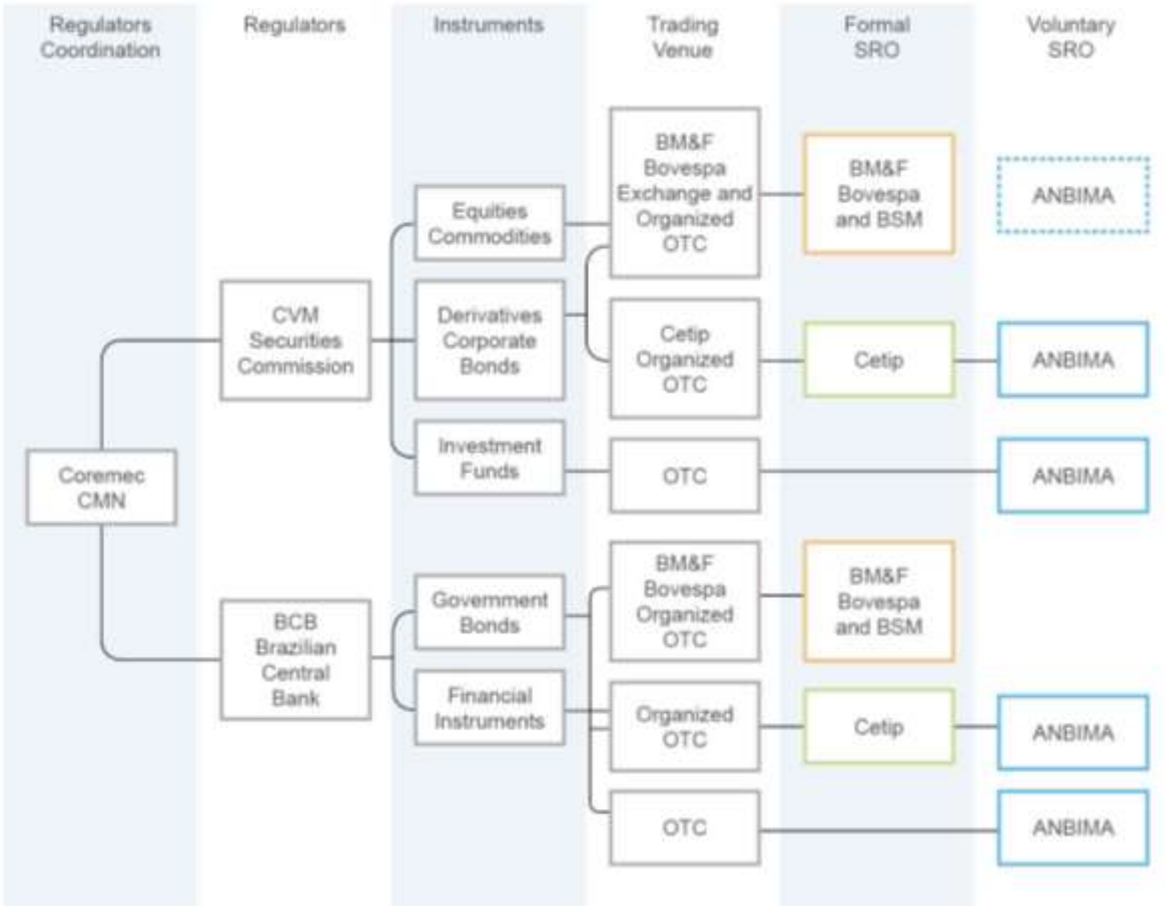
[3] Press Release: FSB publishes Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities. Available at: http://www.fsb.org/2016/06/fsb-publishes-proposed-policy-recommendations-to-address-structural-vulnerabilities-from-asset-management-activities/

[4] IOSCO (1994), Principles for the Regulation of Collective Investment Schemes. Available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD40.pdf.

[5] IOSCO (1997), Principles for the Supervision of Operators of Collective Investment Schemes. Available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD69.pdf.

and the Governor of the Central Bank of Brazil. The CMN has the authority to publish "Resolutions" – rules hierarchically superior to those edited by CVM and BCB. The following diagram depicts the regulatory framework for Brazil, considering both CVM and Central Bank's supervisory mandates.

Diagram 1 – Overview of Brazil's regulatory framework



Source: ANBIMA

CVM rulemaking activity occurs through the edition of instructions and legal opinions. For the current assessment, the most relevant of such rules are **Instruction n. 555**[6], which disciplines the constitution, administration, functioning and disclosure of information regarding investment funds, and **Instruction n. 558**, which lays out authorization, conduct, policies and disclosures requirements for investment fund managers and administrators. The main characteristics of both norms, and other relevant rules, will be presented on the following pages.

[6] Instruction 555 regulates investment funds, in general. More specific rules discipline Creditor Rights Investment Funds (FIDC), Real Estate Investment Funds (FII), Private Equity Investment Funds (FIP) and Venture Capital Investment Funds (FIEE).

3.2. *Funds as condominiums*

Contrary to other jurisdictions (including US and EU), where investment funds are established as investment companies, in Brazil, investment funds are constituted as ***condominiums*** of shareholders. These condominiums can be either open-ended or closed-ended, with regulatory differences relating, for example, to how they are distributed.

One of the implications of this model is that Brazilian funds do not have a "Board of Directors". General Shareholder Assemblies, in turn, have the authority to take most decisions related to the fund. On such occasions, all shareholders are entitled to a vote per share on topics such as the replacement of a fund's service provider (e.g. the administrator, manager or custodian) and any change on the fund's statute or investment policy, among other subjects.

The concept of investment funds as condominiums also implies that losses incurred by the fund are borne by its shareholders, even when liabilities exceed the invested amounts. That is, contrary to funds organized as companies, Brazilian investment funds are *not* subject to the principle of limited liability.

In this framework, if the shareholders consider that the fund manager or administrator is not adequately running the fund (e.g. liquidity is not being adequately managed), then, a shareholder assembly may be called. In this occasion, investors may determine how to proceed, choosing whether or not to effectively replace the fund manager and by whom. This process, however, is seldom utilized.

3.3. *Managers and administrators: different attributions and joint and several liability*

The **fiduciary administrator** ("*administrador*") and **asset manager** ("*gestor de recursos*")[7] are the two main service providers required for an investment fund to function and have fiduciary duties towards funds and their investors. Since Brazilian investment funds are established as condominiums (see above) they have no legal personality. As such, both administrator and the manager act as legal representatives for the funds they manage/administer, sharing, in most cases[8], joint and several liability.

However, it is important to notice these two service providers have different attributions. The fiduciary administrator is responsible for activities that are, directly or indirectly, related the correct operation and maintenance of the fund. As such, the administrator is responsible for compliance and reporting activities. It is also responsible for the communication with investors, the pricing of funds' shares and due diligence towards third party service providers. The manager is, in turn, responsible for executing the investment strategy defined by the funds´ by-laws.

Administrators and managers must be registered at the CVM, according to the provisions set out by Instruction n. 558. This rule, which began producing effects in 2016, significantly increased the

[7] A single institution may provide both services, as long as it is registered for both activities, complies with existing requirements and has implemented adequate policies to segregate one activity from the other.

[8] The recently edited CVM Instruction n. 578 provides for an exception to the joint and several liability between managers and administrators, in the specific case of Private Equity Funds ("*Fundos de Investimento em Participações*" or "FIP").

informational requirements for managers and administrators, to such extent that the new disclosure rules for administrators and managers are comparable to those required of open capital companies[9].

3.4. Transparency

Another specific feature of Brazilian investment fund regulation relates to the existing reporting requirements. Prior to any marketability effort, **all Brazilian investment funds must be registered by the CVM**, and they are all subject to **extensive reporting requirements**. The composition of funds' portfolios and balance sheets, for example, must be monthly reported to the CVM; and this information is later made public on the CVM website[10] which presents a large database, displaying information regarding unit price, net asset value, number of unit-holders, amounts of subscriptions and redemptions, balance sheet information, as well as funds' key information documents.

Brazilian investment funds also have individual accounts at central depositories and trade repositories (e.g. CETIP and BM&FBovespa). This provides the local authorities with an additional source of data on funds, from independent third parties. For supervisory purposes, regarding, for example, derivatives operations, CVM receives weekly data reports from domestic infrastructures on the outstanding positions in derivatives for each registered fund (for more details regarding derivatives operations, see section 3.7, further below).

The transparency requirements also apply to investments in foreign assets. Under Instruction n. 555, CVM opted to expand the investment limits in international assets from 10% to 20% of a mutual fund's total portfolio holdings, under the condition that such investments are subject to disclosure requirements similar to those applicable to investment in domestic assets[11].

3.5. Concentration limits

CVM Instruction n. 555 defines asset and issuer concentration limits for mutual funds. For example, with respect to issuer concentration limits, investment funds constituted according to this instruction must generally comply with a limit of 20% of their net asset value invested in securities issued by a given financial institution, 10% for a listed company and 5% for other private companies (Instruction n. 555, art. 102), unless specified otherwise under this instruction.

These specific limits may be altered according to a fund's class (fixed income, equity, foreign currency and balanced/mixed) and investor classification (retail, qualified and professional)[12]. Balanced/mixed investment funds ("*Fundos Multimercado*"), as another example, are generally understood as the most flexible class in terms of portfolio concentration requirements. Accordingly, investment funds whose

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[9] *Cf*. ANBIMA, "*Of. Dir.* 039/14", the response letter to public consultative document SDM/CVM n. 10/14, regarding disclosure of information from managers and administrators.

[10] http://sistemas.cvm.gov.br/?fundosreg

[11] Investment funds reserved to qualified investors may invest up to 40% of their net asset value on foreign assets, more generally, or up to 100% if they observe certain conditions (including having an investment policy that states that at least 67% of the fund's NAV must be invested in foreign financial assets). Investment funds reserved to professional investors do not have pre-defined regulatory limits on investment abroad. In all cases, the same informational requirements apply, as a precondition for investment in foreign assets.

[12] Qualified and professional investors are mainly defined according to the total value of financial assets they own. For natural persons, the minimum threshold for a qualified investor is a financial asset holding of R$ 1 million; the minimum threshold for professional investors is of R$ 10 million. For a more precise definition of both qualified and professional investors, see CVM Instruction n. 554/14.

distribution is restricted to qualified investors have more flexible limits, when compared retail investment funds, while investment funds reserved to professional investors have no general regulatory concentration limits. For more details regarding concentration limits for each investment fund class and suffix, please refer to the Appendix - Investment Funds classes and suffixes (*cf*. CVM Instruction n. 555).

It is important to notice that, irrespective of these differences in portfolio limits that are required by regulation, all fund categories are registered at the CVM, being subject to the general requirements and supervision applicable to investment funds in general[13]. In this sense, there is **no equivalent to hedge funds in Brazil**.

3.6. Liquidity risk management

According to CVM regulation (Instruction n. 558, art. 23), asset managers are required to implement and maintain written records of risk management policies that allow the monitoring, measuring and permanent adjustment of risks inherent to each portfolio they manage. These policies must be consistent and liable to verification, presenting the procedures, instruments and structures utilized with regards to a series of risks – including the liquidity risk[14]. The fiduciary administrator is, in turn, responsible for diligently supervising the implementation of the risk management policies by the asset manager and is also responsible, jointly with the asset manager, for managing liquidity risks, providing the managers with the data required for this process pursuant to the terms of the agreement among them (*cf*. idem, §4).

Instruction n. 555, for mutual funds, reinforces this notion that both manager and administrator are jointly responsible for the managing of liquidity risks. Article 91 of this rule requires both agents to adopt together policies, procedures and internal controls necessary to ensure that the liquidity of the fund’s portfolio is compatible with the terms of redemption and the fund’s obligations. The second paragraph of this article also requires the administrator to periodically perform stress tests with regards to both assets and liabilities of a fund.

CVM has also expressed in regulatory notices[15] that liquidity risk management policies and procedures should additionally take into account: asset liquidity; obligations (including expected posting of margin and other guarantees); value of redemptions expected in ordinary circumstances; and the dispersion of the funds’ shares. According to these objectives, the domestic regulator defines three procedures that it considers especially important for liquidity management:

i. Liquidity management must begin prior to the constitution of a fund, by defining target markets for shareholders, objectives, strategies, investment policies and redemption terms and conditions;
ii. Administrators’ internal controls must be prepared to calculate the liquidity of a fund’s portfolio precisely and at any time. It should also be possible to estimate outflows, not only due

[13] Notably, all funds’ portfolios are marked-to-market on a daily basis utilizing variable net asset value (VNAV) processes supervised by CVM as well as independently by ANBIMA (this topic is later discussed in section 2.8.).
[14] As discussed in Section 2.10, below, ANBIMA’s Code for Investment Funds (and complementary guidance) provide for more granular requirements to be observed in determining liquidity risk management policies.
[15] “Ofício-Circular CVM/SIN nº 2/15”. Available, in Portuguese, at: http://www.cvm.gov.br/export/sites/cvm/legislacao/circ/sin/anexos/oc-sin-0215/Oficio-Circular-SIN-Gestao-de-Liquidez.pdf

to redemptions, but also due to operational costs and provisions related to derivatives operations;

iii. Stress tests (currently required by CVM Instruction n. 555, art. 91, §2) should not only consider a predefined horizon for observed data, but simulate the potential volatility with regards to asset liquidity, while also considering potential effects from the funds' liabilities (including redemption orders) in period of stress.

Regarding post-event measures, CVM Instruction n. 555, art. 39, allows the fiduciary administrator to close a fund for redemption due to the closure of relevant markets and exceptional liquidity circumstances (even those derived from redemptions incompatible to existing liquidity conditions), among other circumstances. If a fund is to remain closed for more than five consecutive days, the administrator must necessarily summon an extraordinary general assembly, so that shareholders can deliberate upon the following possibilities: the replacement of manager and /or administrator; reopening or maintenance of the closure for redemptions; redemptions in kind; fund spin-offs and complete liquidation.

3.7. Leverage and derivatives

Another particular aspect of Brazilian funds regulation is the credit taking prohibition. Investment managers cannot take loans on behalf of the funds they manage[16], which imposes a strict limit on balance sheet leverage for all funds.

Securities lending and reverse repo operations, in turn, are only allowed when realized through infrastructures authorized by a local regulator. This implies that equity lending operations are CCP[17] cleared, always guaranteed, and registered at BM&FBovespa, the Brazilian exchange, through its securities lending system, labeled BTC[18].

The use of derivatives for investment funds is also regulated. All fixed income fund subclasses have strict limits on leverage through derivatives, for they may only enter into derivative operations for hedging purposes[19] (the remaining classes and subclasses, however, do not have such restrictions). Additionally, CVM requires every fund to disclose, on its by-laws, whether or not it utilizes derivatives only for hedging purposes. If a fund is allowed to utilize derivatives in a manner that results in leverage, then CVM also requests it to inform the maximum possible leverage allowed (as a percentage of its net asset value)[20].

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[16] Article 89, II of CVM Instruction n. 555.

[17] Acronym for Central Counterparty. According to the CPMI Glossary, a CCP is: "An entity that interposes itself between counterparties to contracts traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer and thereby ensuring the performance of open contracts." (Available at: https://www.bis.org/cpmi/publ/d00b.htm?&selection=9&scope=CPMI&base=term)

[18] For more information regarding the service, its eligible assets and a technical description of identification and attributes for every instrument, see:
http://www.bmfbovespa.com.br/en_us/services/securities-lending/information.htm.

[19] Article 111, II; Article 112, III; and Article 113, III of CVM Instruction n. 555. The restriction applies to the sub-categories of fixed income funds labelled as Short term, Indexed, Simple, and External Debt. Derivatives operations must also comply with concentration limits mentioned in section 2.5 of this document. However, it is important to notice that plain fixed income funds, with no subclasses, do not have this restriction on off-balance leverage.

[20] Maximum leverage is defined as the maximum percentage of the funds' net asset value that could be deposited as margin, considering both effective margin, for secured positions, and potential margin, for unsecured positions (CVM Instruction n. 555, Annex 42).

Other regulatory aspects of the CVM regulation (and ANBIMA self-regulation) effectively mitigate fund leverage in Brazil. For example, the liquidity management policies – which are required by regulation[21] and subject to self-regulatory guidelines[22] and supervision – requires that funds have policies, procedures and internal controls in place (including periodic stress testing, for both liabilities and assets). These elements help ensure that funds attain adequate balance between the portfolio liquidity, on one hand, and redemptions and margin calls, on the other hand, in a manner that considers leverage-inducing operations.

The majority of derivatives operations are (and have historically been) exchange traded and, therefore, are centrally cleared. These operations are subject to mandatory margin calls, calculated according to BM&FBovespa robust models. The remaining operations are mainly negotiated in organized over the counter markets (mostly, CETIP) and may also be subject to margin calls, depending on the agreed terms. Either case, all derivative operations are registered, producing data that is regularly available to domestic regulators (see section 3.4., above).

3.8. Distribution

According to the current rules, distribution activities are restricted to those institutions that are authorized to participate in the *distribution system* – these are: investment banks, securities firms, brokers, tied agents and, in the case of investment funds, commercial banks. With recent changes implemented by CVM Instruction n. 558, asset managers may be exempted from this registration into the distribution system, in order to distribute the funds they manage. The exempted manager-distributors, nevertheless, will be subject to the CVM supervision regarding the requirements applicable to the members of the distribution system[23].

Among these requirements, lies the responsibility to conduct suitability assessments. In 2013, CVM edited Instruction n. 539, imposing regulatory suitability responsibility for members of the distribution system, as well as securities advisors[24], generally requiring these agents to verify an investor's profile (including matters related to this client's objectives, financial situation and knowledge) when recommending a product. Through this procedure, local authorities effectively stimulated further improvements in the consistency between investor's behavior and the fund's profile, while building upon pre-established standards set out by the local market's initiative.

3.9. Supervisory Approach

The supervisory model for the Brazilian investment funds industry was fundamentally reformed in 2002 when the supervisory mandate of the CVM was extended to all investment funds (the previous mandate covered only equity funds), taking over the former supervision by the Central Bank of Brazil with respect to

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[21] *cf*. Art. 91 of Instruction n. 555, from CVM

[22] Deliberation n. 67 – Guidelines for Liquidity Risk Management. Available, in Portuguese, at http://portal.anbima.com.br/fundos-de-investimento/regulacao/codigo-de-fundos-de-investimento/Pages/codigo-e-documentos.aspx.

[23] CVM Instruction n. 558, Art. 30 requires that managers wishing to distribute their own funds must comply with Anti Money Laundering, Investor Registration and Suitability rules (the latter is explained in the text). Furthermore, a manager who also distributes its funds must not rely on any other institution to distribute its own funds' shares or quotas.

[24] ANBIMA Investment Funds Code also disposes about suitability requirements for the distribution of such investment vehicles. The Association's standards and supervision of this activity predate the edition of Instruction n. 539 by CVM.

fixed-income funds. This move to a dedicated and specialized supervisor brought significant improvements in the supervision of Brazilian funds. Since that date, the CVM has established a close, hands-on supervision of the funds.

CVM oversight is complemented by ANBIMA´s supervision, which includes the monitoring of the funds´ liquidity and pricing policies as well as exposure profile, based – among other things – on periodic reporting. ANBIMA's self-regulatory codes and policies are briefly presented on the following section.

3.10. Self-Regulation

Brazilian markets have three *formal* self-regulatory organizations ("SROs"), which are: BM&FBovespa, BSM (supervisory branch for the BM&FBovespa holding) and CETIP, each one responsible for different attributions and/or market segments[25]. Even though their SRO activities do not aim specifically for investment funds, asset managers and administrators, they provide another layer of security for these institutions, setting minimum standards and guidance for exchange and organized OTC markets.

ANBIMA, on the other hand, acts as a *voluntary* SRO, exercising the full range of self-regulatory activities – rulemaking, supervision and enforcement – for the market segments it represents. The Association's Market Supervision staff is responsible for ongoing analysis, supervision[26] and oversight activities. The inputs provided by this technical staff are later subject to the assessment of the Monitoring Commissions ("C*omissões de Acompanhamento"*). Once approved, these reports are then sent to the Regulation and Best-Practices Councils (*"Conselhos de Regulação e Melhores Práticas"*), who, in turn, assess opened inquiries and sanction failures in compliance[27]. Both the Commissions and Councils are independent bodies, responsible for supervisory activities regarding members´ compliance with ANBIMA's Codes and Guidance.

Adhesion to ANBIMA Codes is only mandatory for associated members, according to the activities they perform. Non-members, however, may also adhere to the Codes, following a process that includes the formal submission of required documents, compliance to both general and specific requirements, set out by each Code, and sanctioning from supervisory forums. Third party service providers hired by members and adherents may also be required to observe ANBIMA Codes.

As a general rule, ANBIMA Codes are stricter than those published by local regulators, but never opposed to them. All of such are regularly reviewed, updated and/or extended, to reflect changes in the market and ensure the adoption of robust standards and practices across the industry. As a form of attesting compliance to these higher standards, Code adherents may employ an ANBIMA seal in their marketing materials.

In total, there are 12 Codes[28], with the most relevant of which, for the current analysis, being the ANBIMA Code for Investment Funds Regulation and Best Practices[29]. This document was first adopted in 2000 and

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[25] BM&FBovespa and BSM act as SRO exchange and organized markets for equities, commodities and derivatives; as well as organized OTC markets for financial instruments, corporate and public bonds markets. CETIP, in turn, acts as a formal SRO for the organized markets for derivatives, financial instruments, corporate and public bonds. Table 1, in section 2.1., presents this information in a more comprehensive format.

[26] The monitoring and verification of compliance to the codes follows five supervisory tools: periodical, indirect, thematic and episodic assessments and complaints.

[27] Regulation and Best Practices Councils may also publish additional Guidance for the Codes.

[28] The 12 ANBIMA Codes are the following:

- Public Offerings

has since been extended and strengthened. Currently, the document covers topics related to requirements for both investment funds (including registration, data reporting, documentation and mark-to-market standards) and service providers (administrator, manager, distributor, among others), as well as defines ANBIMA's supervisory structure and the sanctions applicable to Code adherents due to non-compliance.

To provide further clarification on its standards, ANBIMA's Code for Investment Funds is also accompanied by a series of complementing deliberations and guidance. For example, Deliberation n. 67 disciplines Liquidity Risk Management Policies, defining additional procedures to current regulation, while also bringing additional recommendations regarding specific topics, such as the treatment of OTC Derivatives (art. 13)[30]. Other Deliberations set standards for mark-to-market appraisals (Deliberation n. 75), procedures for provisional non-compliance to portfolio limits (Deliberation n. 74), Suitability (Deliberation n. 65) and risk disclosure metrics for the key information document (Deliberation n. 64), among other topics.

Finally, it is also important to notice that ANBIMA establishes a Fund Classification system. Complementary to the class and subclass framework established by CVM, ANBIMA Fund Classification intends to categorize each fund in manner that better reflects their objectives and investment policies, separating and identifying strategies and main risk factors. The Annex to Deliberation n. 71 presents objective parameters (including portfolio limits) that relate to the standardized categories and subcategories.

This concludes our introductory presentation of the most relevant aspects of Brazil's regulation and autoregulation for investment funds, managers and administrators. During the next sections, we will present our comments to the questions posted by the FSB Consultative Document, taking into account the concepts and characteristics mentioned above.

- Public Offerings analysis under the MoU with the CVM
- Investment Funds
- Private Equity and Venture Capital Funds
- Certification
- Qualified Services (incl. Custody)
- Private Banking
- Wealth Management
- New Market for Fixed Income
- Trading of Financial Instruments
- Retail Distribution
- Code of Processes

[29] http://portal.anbima.com.br/fundos-de-investimento/regulacao/codigo-de-fundos-de-investimento/Pages/codigo-e-documentos.aspx

[30] ANBIMA's standards related to liquidity management are further explained in the replies to questions related

4. General Questions

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.

The FSB initiative to identify structural vulnerabilities associated with asset management activities, with regards to risks to financial stability is commendable, especially if one considers to its scope and coverage. As we have already stated at the beginning of section 3, the regulatory structure of investment funds and asset managers varies significantly across jurisdictions and these differences in regulatory structures make the identification of common structural vulnerabilities a complex undertaking.

Consequently, attempts to present the results of this non-trivial analysis as a linear narrative necessarily entail more attention to certain aspects, in detriment of others. Like the drawing of map, which requires simplification of the real space in order to represent it in a descriptive manner, the narrative for structural vulnerabilities presented at the Consultative Document had to honor certain aspects, instead of others.

The Consultative Document is at its strongest when identifying recent trends observed in central economies (e.g. the search-for-yield). Still, the trends it identifies may not the most adequate to describe the conjuncture faced by other economies.

In Brazil, for example, policy interest rates are of 14.25%, much higher than those rates that could justify search-for-yield behavior; mutual funds register very low leverage, in aggregate, which can be observed through a varied range of metrics[31]; business continuity plans are already demanded by the national regulator; and asset lending is only realized through registered infrastructures, not following the described agent lender model. Even though these are just some of the characteristic of our national markets that, in our perspective, act as effective mitigants to the risks and vulnerabilities proposed by the Consultative Document, they serve to illustrate the point that some of tendencies identified (e.g. fund managers acting as agent lenders) are not necessarily relatable to the Brazilian reality.

This does not mean that there are no structural vulnerabilities for the Brazilian markets that need addressing, though. The most gaping one is the lack of liquidity in secondary corporate bond markets, which is structurally low, for both national and international standards. But this issue is mostly out of the scope of the proposed mandate for the Consultative Document and, therefore, should not warrant identification proposals for FSB's appreciation, with regards to this current line of work.

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[31] The Brazilian CVM has edited a working paper ("*Texto para Discussão*"), in July/16, discussing potential risks related to leverage in investment funds, with regards to the regulator's mandate to protect investors and the financial stability of the system. The analysis approaches several aspects of this topic, including a presentation of international regulatory benchmarks (including the requirements applicable to US mutual funds, and European UCITS and AIF), national regulation and market data. When analyzing the data for the Brazilian markets through a range of metrics (including Gross Notional Exposure and Margin, as a proxy for risk), the national regulator concludes that leverage is very low for the industry as a whole (apart from some exceptional cases).
The Working Paper, written in Portuguese, is available at:
http://www.cvm.gov.br/export/sites/cvm/menu/acesso_informacao/serieshist/estudos/anexos/Paper_Alavancagem__FINAL270716.pdf.

Our comments to the Questions regarding the vulnerabilities identified by the consultative Document (which are presented on sections 5, 6, 7 and 8 of this document) further develop on the examples presented above (and some additional ones), for each one of the identified vulnerabilities that are presented by the Consultative Document.

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?

Building upon our comments to Question 1 (right above), the perception that the narrative for the identification of structural trends and vulnerabilities can be better suited for a specific set of jurisdictions directly leads to concerns with regards the adequacy of ensuing policy recommendations for the other set of jurisdictions.

When policy recommendations assume more prescriptive outlines, these concerns regarding identification of risks, trends and vulnerabilities become more relevant. In situations where current risks and vulnerabilities are misidentified (or are already addressed by non-identified mitigants), prescriptive recommendations might fail to address its targets and, at worse, could provoke unidentified consequences. Examples of these more prescriptive policy recommendations can be found on sections 2.4.2 and 2.4.3., in which the Consultative Document proposes recommendations to address gaps in liquidity management and the adequacy of liquidity risk management tools to deal with exception circumstances[32]. As we point out in our comments to Question 5, one of these recommendations advocates that regulators should allow the use of Swing Pricing - yet this might prove to be an issue for some jurisdictions(e.g. due to it possibly generating artificial valuation differences and operational challenges or to legal restrictions).

Nevertheless, many of the policy recommendations aim at providing local authorities and asset managers the tools and data to effectively detect and address the identified risks. We commend the FSB for opting for this approach, that is taken on many parts of the Consultative Document, since strengthening supervisory tools is more advisable than prescribing rulemaking initiatives when the analyzed situation involves risks that have not yet materialized or are difficult to measure. The vulnerabilities associated with liquidity mismatch, leverage, operational risk and securities lending, can generally relate to at least one of these characteristics.

Another important aspect that we respectfully suggest that the FSB consider is the role played by standard setting entities and SROs, in defining rules and guidelines as well as in conducting supervision and monitoring initiatives. Standards and guidelines for best-practices set through market initiatives are also relevant drivers for mitigating identified risks that are not covered by regulation and, as such, might address some of the residual risks identified by the Consultative Document

[32] For more details on these matters, please refer to our comments to Questions 4 to 8, on the next section.

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.

ANBIMA has previously mentioned, on its reply to the IOSCO Task Force on Cross Border Regulation[33], that international standard setting bodies (such as the FSB and IOSCO) could play a fundamental role in mitigating unintended consequences of the adoption of a regulation in one country without the consideration of their effects on third countries. Consequently, we applaud the FSB's initiative to consult for unintended consequences and practical difficulties at the current, high level stage of its analysis is also commendable.

The more prescriptive rulemaking policy recommendations are, once more, the ones that generate more concern, in terms of possible unintended consequences. The misidentification of risks and vulnerabilities for a certain set of jurisdictions may prompt such consequences if policy recommendations are applied without regard the intrinsic characteristics of each of jurisdiction (see, for reference, our comments to Questions 1 and 2).

In this sense, the unintended consequences of international standards might prove to more taxing on fund markets and segments that are already heavily regulated and supervised (as is the case of Brazil). The implementation of international standards, in this case, might increase compliance burden in segments whose risks had already been mitigated through specific, local characteristics. Overregulation risk is an issue that must be considered when defining international standards, since multiplicative requirements may lead to restrictions on the asset management industry's capacity to sustain its sound growth. As we have already stated, these matters will be most costly to jurisdictions where local requirements and market practices had already lessened the identified risks through channels different than those acknowledged by the policy recommendations.

The most important practical difficulties associated to the proposed policy recommendations, in our perspective lies in the definition of a leverage measure that is comparable across different jurisdictions. In this respect, it is important to first identify different investment vehicles that share similarities – at least in terms of leverage rules. Our comments to Question 13 further develop upon this concept that international aggregation of leverage data should be preceded by an identification of vehicles that are being aggregated. After all, it would make little to no sense to compare, for example, an aggregate of North-American hedge funds with Brazilian fixed income mutual funds.

Nevertheless, it is important to stress that the current assessments of potential unintended consequences and implementing difficulties cannot provide for exhaustive conclusions. Both issues could only be completely assessed once the proposed policy recommendations in fact start to be implemented and interact with other, existing requirements. The current assessments on such matters, therefore, may be

[33] ANBIMA (2015). Response to theIOSCO Task Force on Cross-Border Regulation. The document is available at: http://portal.anbima.com.br/informacoes-tecnicas/regulacao/regulacao-internacional/Documents/GTRI_arquivo_IOSCO_CBTF_answer_final2302doc.pdf

subject to revisions when the policy recommendations start to be implemented and the interaction with different rules and requirements prompt unforeseen consequences and difficulties.

5. 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?

In our perspective, the scope of the proposed recommendations on open-ended funds liquidity mismatch might be more appropriate to some jurisdictions (mainly, central economies) than to others. This stems from the fact that, when identifying the *structural* vulnerabilities associated to liquidity mismatch, the consultative document presents some arguments that mostly relate to the *conjuncture* currently faced by some economies (e.g. prolonged period of highly accommodative monetary policies; increasing buy-side activity in financial intermediation, as in the case of US corporate bond markets) and not others.

Take the case of Brazil, for example. The current monetary policy target interest rate (SELIC) is of 14.25% p.a.; while the 12 month accumulated inflation rate (IPCA) is of 8.74%[34], as of June 2016. The Monetary Policy Committee's (COPOM), in its July meeting, concluded that: "taken together, the baseline scenario and the current balance of risks indicate **no room for monetary easing**"[35].

Thus, contrary to the narrative presented in section 2.1. of the Consultative Document, Brazilian markets do not face a prolonged period of accommodative monetary policy. This current conjuncture does not incentivize investors' **reach for yield** and we have not identified signs that investment funds, in the aggregate, have increased their holding in a broader range of assets. As a matter of fact, a majority of open-ended funds' holdings, in aggregate, remains invested in money markets.

The Consultative Document's proposals, however, do not relate to **money market funds**, in light of the policy recommendations that have already been developed by the FSB and IOSCO for these types of funds[36]. For the Brazilian markets, this is especially relevant, since a very significant portion of open-ended funds regulated by CVM are either strictly defined as money market funds or realize operations that closely resembles that of money market funds (e.g. national treasury bonds and federal securities repos).

To sum up our argument, we understand that there is no indicator that currently points to new developments in Brazilian markets that might amplify existing vulnerabilities, if left unattended. As the FSB Consultative Document points out: "historical evidence suggests that non-money-market open-ended funds have not created global financial stability concerns in recent periods of stress and heightened volatility". With no recent developments to suggest increased risk, we, therefore, conclude that current policies adopted by Brazilian open-ended investment funds are adequate for the liquidity profile of our national markets.

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[34] Source: Central Bank of Brazil. Available at: http://www.bcb.gov.br/en/#!/home.

[35] COPOM (2016). *Minutes of the 200th Meeting of the Banco Central do Brasil Monetary Policy Committee (Copom)*. Available at: http://www4.bcb.gov.br/pec/gci/ingl/COPOM/COPOM20160801-200th_Copom_Minutes.pdf.

[36] Consultative Document, Page 1, note n. 2. For further reference: http://www.fsb.org/wp-content/uploads/shadow_banking_overview_of_progress_2015.pdf and https://www.iosco.org/library/pubdocs/pdf/IOSCOPD502.pdf.

This does not mean, however, that there are no liquidity issues that need consideration if Brazilian bond markets are to present a sustainable growth. Liquidity in secondary corporate bond markets, for example, is – and has long been – structurally low, for both national and international standards. Even public treasuries, one the most liquid assets in relative terms, for the national markets, do not fare so well when compared to the standards of most central economies (especially when one considers liquidity metrics normalized by outstanding debt). These matters, however, are out of the scope of the current assessment.

Q5. What liquidity risk management tools should be made available to funds? What tools most effectively promote consistency between investors' redemption behaviours 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?

As pointed out in the Consultative document, liquidity management tools may assume different forms. In this sense, it is not only critical to understand which tools must be made available, but to whom and when.

Certain tools, for example, might be left at the discretion of the fund manager alone, while others must be executed by the administrators and some, at least in Brazil, can only be implemented if the general assembly so decides. Additionally, certain tools must be determined at fund inception, while some must be employed on an ongoing basis and others are only applicable after a liquidity event has materialized.

The following table sums up the risk management tools we support, categorized according to the two characteristics that are mentioned above (who has discretion on the employment of these tools and when).

Table 1 – Proposed liquidity Management Tools

	Fund inception[37]	**Pre-event**	**Post-event**
Manager	• Determination of investment policies	• Regulatory concentration limits • Liquidity risk management policies and procedures • Stress tests – for both assets and liabilities	• Suspension of redemptions (for up to 5 days)
Administrator	• Redemption terms, including: – Frequency – Fees **(when applicable)**[38] • Determination of investment policies	• Send information about redemptions and investments to fund managers • Mark-to-market valuation; • Calculation of NAV; • Disclosure and reporting	• Suspension of redemptions (for up to 5 days)
General Assembly/ Investors	---	---	• Suspension of redemptions (for more than 5 days); • Redemptions in kind **(when applicable)**; • Spin-offs; • Complete liquidation; • Additional contributions[39]
Distributor	---	• Suitability	---

Source: ANBIMA

[37] The tools that are described under the "Fund inception" row must be present in the investment vehicle's by-laws.

[38] Fees could be applied in relation to early redemptions, which are realized prior to a stipulated term. These fees, and their conditions, must necessarily be disclosed in a fund's by-laws.

[39] Due to the condominium nature of Brazilian investment funds, their shareholders may be summoned to provide extra contributions in extreme circumstances, to honor fund's obligations. This has been utilized on very rare occasions. Nevertheless, it is important to stress that open-ended investment funds are closed for new applications while they are closed for redemptions; the fund that results from a spin-off is also closed for new applications (CVM Instruction n. 555, art. 39, §§4 and 6).

Since the Consultative Document already mentions the majority of these tools in section 2.2. as existing mitigants to address the identified vulnerabilities, it is not necessary to exhaustively describe all of them. However, it is worth mentioning a couple of comments for some of them:

- Stress testing is a prerogative for adequate liquidity risk management, since it allows managers to better grasp market behavior under stressed conditions. In Brazil, managers must publish their risk management policies and conduct regular stress tests not only for assets, but for liabilities as well, providing a better understanding of investors' redemption behavior and the liquidity profiles of funds;
- Administrators must publish the manuals they utilize for realizing mark-to-market valuations. These agents are responsible for the regular fair valuation of assets and funds' quotas, which provides greater transparency regarding asset valuation and how it responds to shifts in market liquidity;
- Administrators may suspend redemptions for up to five consecutive days, due to extraordinary liquidity situations. If this suspension is to be kept for more days, a General Assembly must be summoned to deliberate on topics such as the extension of this suspension, the fund's spin-off complete liquidation, changes of manager/administrator and more.
- Distributors, as mentioned in section 3.8. of this document, must conduct suitability assessments regarding investors' and funds' profiles. This also helps promoting consistency between investors' redemption behaviors and the liquidity profiles of funds.
- The almost entirety of investment funds operations are negotiated in organized markets;
- The regulatory treatment of investment fund taxation in Brazil prompts elongation of fund portfolio duration, since long term investment funds enjoy a tax incentive (when compared to short term funds). Therefore, the determination of fund duration is a process that is many times dictated by its impacts on the tax treatment, even though this decision should ideally be left to the manager's discretion;

Finally, it is important to stress that **swing pricing** is a tool that is not necessarily an adequate form of addressing liquidity risk mismatch and investors' incentives in every jurisdiction. It is our understanding that the application of these tools might create artificial valuation differences in a fund's shares or quotas, indicating unduly differences in performance towards other funds that do not utilize such tool (this is especially relevant when funds' quotas/shares are calculated on a daily or quasi-daily basis). Other known issues associated related to Swing Pricing are the operational challenges in adapting internal systems and procedures to comply with this tool and legal concerns regarding the validity of this tool in certain jurisdictions.

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.

As a general principle, managers should analyze the liquidity of invested assets and the behavior of liabilities, in both normal and stressed market conditions, on a regular basis. The liquidity risk management policies of each manager dictate these processes, also providing for directions to the investment in illiquid assets. This provides the fund managers additional tools for complying fiduciary responsibility towards investors and their rights to redemption (according to the pre-established terms), without the need for regulatory guidance.

In Brazil, the market's own initiative led to the edition of ANBIMA's Code for Investment Funds and the corresponding Guidance[40], to complement regulatory rules on a series of matters, including liquidity risk management. Defining additional standards for the requirement set by the national regulator, ANBIMA's Code for Investment Funds obliges adherent fund managers to set out more detailed liquidity management processes and policies according to minimum standards. The policies defined by each manager must be registered at ANBIMA, being subject to the appreciation of the market supervision staff.

The more granular self-regulatory requirements are set for the assessment of liquidity in investment in private credit. ANBIMA's Guidance defines the minimum procedures for measuring liquidity for funds that are not restricted to qualified investors and invest 10% or more of their NAV in private credit instruments. These procedures relate to the analysis of both assets and liabilities.

On the asset side, the liquidity adjusted term ("Paj") is the product between the asset cash flow terms ("*Pfi*") and a liquidity factor ("*Red*"). This "*Red*" liquidity factor, in turn, is determined as the product of two variables, $Fliq_1$ and $Fliq_2$[41], whose values are assigned according to tables published by ANBIMA. The lower factors assigned to the more liquid assets, for they result in shorter liquidity-adjusted terms.

Managers must also conduct similar analyses for the behavior of a fund's redemptions. These analyses must also be structured according to some specific vertices.

Once the analysis of both assets and liabilities are concluded, their results must be compared, to assess possible liquidity mismatches and their reasons. Fund managers can, then, act according to the pre-established policies and procedures to mitigate liquidity risks and warrant their fiduciary mandates towards investors.

[40] *Cf.* "Deliberation n. 67" and the corresponding "Methodology for the Calculation of Liquidity for Funds' Investment in Private Credit Assets". Both are available, in Portuguese, at: http://portal.anbima.com.br/fundos-de-investimento/regulacao/codigo-de-fundos-de-investimento/Pages/codigo-e-documentos.aspx.

[41] $Fliq_1$ incorporates the liquidity characteristics of certain instruments. $Fliq_1$ and ranges from 0% (most liquid instruments, such as overnight deposits and national treasuries) to 100% (least liquid) $Fliq_2$, in turn, discriminates between issuances that are more negotiable, assigning a 50% factor (instead of 100%) for assets that are considered more liquid than other instruments from the same category.

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.

Comments: Please refer to table that is displayed in our comments to Question 5. This table already anticipates which tools are optional and, as such, should not be expected to be employed by every open-ended fund in a certain jurisdictions. The tools that should be optional are: redemption fees and redemptions in kind. The former is a discretionary investment fund redemption policy; while the latter should be available only to funds with professional or qualified investors, since redemptions in kind involve more complex processes (e.g. ownership transfer, custody arrangements etc).

The remaining tools presented in table 2 should be adhered by every open-ended investment fund. Still, it is important to notice that the application of liquidity management usually requires tailor-made policies that are adequate to each investment funds' profile (and, as such, to their investors' profiles). One-size-fits-all policies can be counterproductive to address the vulnerabilities described in the consultation.

As a corollary to this argument, we understand that both regulation and self-regulation should authorize the utilization of liquidity tools described in table 2 (except for two of the tools, which are optional), while also providing guidance and minimum standards for them. Supervision, in this sense, should cover an important role in assessing the adopted measures.

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.

Comments: Since exceptional liquidity risk management tools generally affect the investors' rights to redeem their invested resources, these agents retain the final authority to sanction (or not) the utilization of such tools in some jurisdictions.

In these situations, regulators do not have the legal mandate to direct the use of exceptional liquidity policy. By ordering the closure of a fund, for example, these national authorities (and their statutory directors) would become legally responsible for such decision. Thus, it must be pondered if regulators are willing to assume the responsibility for the decisions to direct the use of exceptional liquidity management tools.

Our perspective is that authorities should be capable of advising the utilization of such tools, but not directing them.

In Brazil, the fiduciary administrator has the authority to close a fund for up to five days, due to exceptional liquidity events or to redemption order that are incompatible with the funds' liquidity. If a fund must remain closed for more than five consecutive days, the administrator is required to summon an extraordinary general assembly. In these circumstances, investors are entitled to one for per share, and can deliberate on topics such as: suspension of redemptions for more than five consecutive days, fund splits, complete liquidation, redemptions in kind and the substitution of the administrator and/or manager.

6. Leverage within funds

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?

Comments: When further developing topics related to Recommendation 10, the Consultative Documents proposes four principles that should be considered by IOSCO when developing both simple and consistent as well as risk based measured. For short, these four principles can be referred as: synthetic leverage; netting and hedging; directionality of positions; and model risk.

In our perspective, the principles regarding synthetic leverage and netting/hedging are both appropriate and welcome additions. Proper identification of synthetic leverage is relevant especially for recognizing, as the Consultative Document states, that derivative operations may be utilized for a wide range of purposes, not only leverage. This is an important notion that is oftentimes overlooked and, as such, we appreciate the FSB for incorporating this aspect as recommended principle for the development of leverage measures.

We also appreciate the Consultative Document for acknowledging that netting and hedging effects alter true economic leverage. For this reason, it is also important that IOSCO considers netting and hedging when determining leverage measures.

Model risk is another relevant principle for IOSCO's consideration. Since leverage is not explicitly observable – even more so if one considers the two principles mentioned above – it is necessary to consider model risk as manner to avoid over- or underestimation of economic risks. To mitigate model risk, we propose that there should be a *single* model – and not two (please refer to our comments to Question 10, below).

The directionality of positions, as we understand it, however, should not be deemed an appropriate principle for IOSCO's reference with regards to Recommendation 10. To quote the example presented in the Consultative Document, the distinction between payment obligations from long and short positions is a matter that should be addressed by the liquidity risk management policies and procedures and, thus, should not be considered for leverage matters.

Finally, it is our opinion that two additional principles shall be taken to IOSCO's consideration. The first is additional principle is that the measure developed by IOSCO should reflect a fund's **exposure to capital risk**, measured as the **maximum potential loss incurred in stressed scenarios**. In our understanding, the maximum potential loss incurred in stressed scenario is the indicator that is most appropriate, in terms of risk, for the classification of the product and for investor disclosure. Our comments to Question 11, below, further develop this concept, proposing a method for measuring this metric.

The second additional principle for IOSCO's appreciation should be the consideration of **margin** (both posted and potential) when elaborating the methodology to measure the above-mentioned exposure to capital risk, since "margin" is an effective measure for the resources required by a fund to fully liquidate its economic exposure in stressed market conditions *and* a mitigant for counterparty risk. The methodology for determining margin is also commonly determined by independent third-parties (for example, central counterparties or international associations), which provides for an increased transparency and standardization.

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?

Comments: In our perspective, having two standard measures for leverage can be counterproductive. With both a simple and consistent and a risk-based measure available for investors, the comparison between two or more investment funds may be compromised if these vehicles do not utilized the same metric. This is especially relevant if one considers that the perception of investors (even more so, retail investors) with regards to leverage is commonly associated with inherent risk. Thus, distinct measures that could provide, as an output, representative values that are higher/lower for a same economic exposure could unduly generate competitive disadvantages/advantages for the subset of funds that utilizes them.

As such, we respectfully propose that FSB and IOSCO consider the development of standards for a **single** measure. This unique metric should be simple enough, in order to be employed on an industry wide basis, consistent, for allowing comparison, and yet be sufficiently risk based, to reflect the effects of stressed market conditions (with shocks in different risk factors). A suggestion is presented on our comments to the following question.

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

Comments: Building upon our comments to the previous two questions, we urge the FSB to consider, for its policy recommendations, the maximum potential loss in stressed scenarios as an appropriate measure for exposure to capital risk that is simple, consistent a sufficiently risk-based.

With this methodology, managers can estimate the maximum potential loss each fund could incur, given a certain, predefined stress scenarios, thus, assessing the extent of a fund's exposure to capital risk. As we have already mentioned on our comments to Question 9, this information is more valuable for investor disclosure and classification of products, in terms of risk, then leverage.

ANBIMA has developed a methodology[42] for measuring maximum potential loss in stressed scenarios for Brazilian investment funds. This method assesses the theoretical behavior of a fund's portfolio under stressed conditions, under three scenarios: current portfolio, potential portfolio and the BM&FBovespa (the Brazilian exchange and central counterparty) envelope scenarios.

For the two first scenarios, seven risk factors were considered (e.g. nominal interest rate, exchange etc). Shocks to each one of these factors were determined according to an assessment of the worst monthly variation registered in recent historical data.

Simulations of these shocks can be realized considering each fund's current and potential portfolios (according to the maximum risk limit available)[43]. The maximum potential losses in these stressed situations are, thus, obtained as the simulated losses resulting from this analysis.

[42] This method was developed by an internal Working Group, as an input for the discussion of a joint Working Group between ANBIMA and CVM. It is not a Self-Regulatory requirement, nor is its execution supervised by ANBIMA.
[43] This applies to Fixed Income, Balanced/Mixed and Equity funds.

To compare these results, ANBIMA also suggests the utilization of the envelope scenarios published by the BM&FBovespa[44]. The Brazilian Exchange publishes and regularly reviews a set of scenarios for primitive risk factors, which can be utilized by market participants for the calculation of margin and other collateral structures. The two most extreme scenarios, one bearish and one bullish, are labeled "envelopes". The utilization of these envelopes acts as a mitigant for model risk, since it provides an additional source for comparison and verification of the results obtained by the other two scenarios.

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

Comments: For this question, we consider the benefits and challenges associated to measuring the Exposure to Capital Risk (ECR), according to maximum potential loss in stressed scenarios (for a more detailed explanation of this methodology, please refer to our comments regarding Question 11). For comparison, we also discuss the challenges and benefits associated with Gross Notional Exposure (GNE)[45].

A first set of benefits associated with the ECR methodology, is the compliance with three of the four principles listed by the Consultative Document (Recommendation 10): the maximum potential loss in stressed scenarios can provide a robust treatment of **synthetic leverage**, reflect the effects of **netting and hedging** and mitigate **model risk**.

The treatment of synthetic leverage in the ECR methodology has the benefit of differentiating the effects of operations that effectively increase the fund exposure to capital risk to those that do not. This methodology also incorporates the effects derived from future changes in exposures to derivatives through the assessment of stressed market conditions and distinguishes shocks to different risk factors (such as basis risk, exchange etc).

The effects of netting and hedging are incorporated in the ECR methodology, for both which must be incorporated by the manager when calculating the potential loss in stressed market conditions.

Furthermore, this methodology has two model risk mitigants: the utilization of a single model and the consideration of three different scenarios – one of which is established by an independent third party (the Brazilian exchange and central counterparty, BM&FBovespa).

Apart from complying with these principles, we consider that the ECR methodology is, at the same time, **simple and consistent** and **risk-based**. This measure does not require complex data analysis or expensive technological resources, it can be sufficiently standardized for comparison across different investment funds and takes into account stressed market conditions, with shocks to pre-established set of risk factors.

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[44] In total, BM&FBovespa publishes 10.000 scenarios for each risk factor, considering a 10-day holding period. For simplicity, only envelope scenarios were considered in ANBIMA's methodology. For more information (in Portuguese), see:http://www.bmfbovespa.com.br/pt_br/servicos/market-data/consultas/mercado-de-derivativos/garantias/requerimento-de-garantia/cenarios-para-os-fatores-primitivos-de-risco.htm.

[45] This measure is utilized by the SEC in its proposed rule "Use of Derivatives by Registered Investment Companies and Business Development Companies" and by IOSCO and FSB in the 2nd Consultative Document for the Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions For further reference, see: https://www.sec.gov/rules/proposed/2015/ic-31933.pdf; and http://www.fsb.org/wp-content/uploads/2nd-Con-Doc-on-NBNI-G-SIFI-methodologies.pdf

The main challenge in applying this methodology, on the other hand, lies in its consistent implementation across different jurisdictions. This stems from the fact that the stressed scenarios are usually contingent on the features of each market. Thus, a possible suggestion for addressing this challenge is that stress scenarios should be established for each jurisdiction according to the same internationally defined standards. This means, for example, considering the worst historical events in each market for the same historical periods (say, five or ten years) and risk factors.

Contrarily to the ECR method, the gross notional exposure measures of leverage do not take into account synthetic leverage, nor does it take into account the effects of hedging and netting in mitigating true economic risk. In effect, GNE measures, for a determined investment vehicle, the sum of its exposures in absolute values, so it does not distinguish between risk factors and terms. Even though obtaining this measure is a relatively easy exercise, it cannot be utilized to effectively measure true leverage risks or – more importantly – capital risk.

The benefits and challenges presented in the current assessment are summed up on the following table.

Table 2 – Benefits and challenges associated to Exposure to Capital Risk (according to the maximum potential loss in stressed scenarios) and Gross Notional Exposure measures

	Exposure to Capital Risk (maximum potential loss)	**Gross Notional Exposure**
Benefits	- Considers Synthetic Leverage; - Considers the effects of hedging and netting; - Distinguishes between different risk factors; - Low model risk; - Simple and consistent; - Risk sensitive.	- None
Challenges	- International implementation	- Does not consider synthetic leverage; - Does not consider the effects of hedging and netting; - Does not distinguish between different risk factors and terms - Does not effectively reflect risks.

Source: ANBIMA

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)?

Comments: For the aggregation of national/regional data on leverage to be successful, IOSCO should first consider to conduct an assessment regarding the characteristics of the products in each jurisdiction. This assessment should address, for example, the regulatory structure of investment vehicles considered in each jurisdiction, the leverage-inducing operations that such vehicles may realize, which limits and other investment restrictions apply.

Since the nature of investment funds that may utilize leverage varies in many ways, it is important that every aggregation effort considers these differences. After all, an aggregate of leverage measures for distinct products shall have little interpretative meaning for regulatory policy analysis.

Once this taxonomy of investment funds due to characteristics related to leverage is established, the frequency of the collection of aggregate data can be assessed according to the longest reporting period for each jurisdiction and investment vehicle category considered. For example, a data collection and aggregation exercise for short-term mutual funds registered in the Americas should be realized in accordance to the longest regulatory reporting period for such funds, in any such jurisdiction.

A possible benefit of this proposal is that it could be utilized to promote a better understanding of similarities between vehicles registered in different jurisdictions.

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?

Comments: The interaction between liquidity and leverage is not necessarily linear or trivial. As such, we understand that only a holistic assessment of the interactions between the two sets of policies, once implemented, might provide a definitive answer to this question.

In this sense, we encourage the FSB to consider including, in future progress reviews of the operationalization of the recommendations, the periodic assessments on how the proposed policy recommendations are addressing the interactions between leverage and liquidity.

However, as we have already anticipated in our reply to Question 9, there are some initial modifications that might already be applied so the proposed policy recommendations could better address the interaction between liquidity and leverage.

First, is the inclusion of "margin" as a principle for IOSCO's consideration when developing leverage measures. We respectfully suggest that the FSB and IOSCO consider the importance of collateral (both posted and potential) due to its effect in mitigating counterparty risks and also acting as a backstop for operations that increase exposure to capital risk.

The Brazilian CVM, in its Instruction n. 555, establishes potential margin as the regulatory leverage metric of choice, for mutual funds. This metric reflects the resources that a fund would be required to employ in order to fully liquidate its economic exposure in stressed market conditions and, as such, also figure as a valuable input for managing liquidity risk.

A second suggestion is the exclusion of "directionality of positions" as a principle for the development of leverage measures. Coordination of distinct payment obligations is, by definition, a matter that dictates liquidity management. Depending on how this input is incorporated into leverage measures, it might generate a negative feedback between liquidity and leverage risks – especially if the standardized metric is later utilized for the definition of strict regulatory limits on leverage, thus providing for additional structural risk.

7. Operational risk and challenges in transferring investment mandates or client accounts

Q15. The proposed recommendations 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 recommendations 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 the application that you believe is appropriate and its rationales.

Regulatory requirements or guidance to address operational risks and challenges in transferring investment mandates should generally apply to fund managers and administrators. Thus, requirements to present business continuity plans, for example, should be irrespective of size, complexity and services provided by a manager, while these characteristics should be addressed by such documents, to the extent they prove relevant for the transfer of mandates.

The need to ensure adequate transfer of investment mandates between fund managers or administrators should not be taxed as a matter related to the systemic relevance of a determined segment or set of players. When it comes to investment funds, the adequate transference of investment mandates is, by definition, a necessity for ensuring the regulator's investment to protect investors and the funds service providers' (i.e. manager and administrator) fiduciary responsibilities towards investors.

However, it is important to stress that the tools to ensure these transfers of mandates in exceptional circumstances vary across jurisdictions. In Brazil, for example, all managers and administrators are already required by CVM Instruction n. 558 to adopt both contingency and business continuity plans. Both of these are mentioned at Recommendation 13 and should, as we have stated above, be required of all managers and administrators. As described at section 4.2 of the Consultative Document, these plans help address operational challenges and enable orderly transfer of investment mandates.

Other relevant mitigant for operational challenges to orderly transfer on investment mandates that needs mentioning, and is not explicitly addressed in the Consultative Document, is that assets from each investment fund are registered in independent accounts (segregated from that of the manager and other funds managed by a same company). This facilitates transfers of investment mandates between managers in cases where the transfer of assets is not needed.

In order to further illustrate the differences among the scenario and mitigating factors among the various jurisdictions, it is also noteworthy that, in Brazil, the requirements of an external custodian and the responsibilities of the fund administrator (including its performance in hiring and supervising most ancillary services and the possibility that the fund administrator acts as a transitional manager if the asset manager has to be replaced) may work as additional mitigating factors to the operational risk in transferring investment mandates. Therefore, it seems advisable that the final policy recommendation on this matter preserves the discretion of the local authority to evaluate to what extent additional requirements to address any residual risk associated with operational risk and challenges in transferring investment mandates or client accounts are in fact necessary.

8. Securities lending

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 already stated in section 3.7 of this document, in Brazil, investment funds can only realize securities lending activities if these are realized through infrastructures authorized by a national regulator. Equity lending activities, more specifically, are only realized via the BTC system, a service provided by BM&FBovespa. These activities are all CCP guaranteed, cleared and registered, so that all information regarding these operations is registered and available for the national regulators' appreciation.

Consequently, the Brazilian model for securities lending is different from the agent lending model described by the Consultative Document (e.g. counterparty risk for these operations is, by definition, that of the CCP) and does not account for the same risks presented by this Document.

Therefore, we abstain from providing comments on the information and data items authorities should monitor in relation to indemnifications provided agent lenders that are also asset managers.

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)?

Since there are different existing models for securities lending activities (such as the Brazilian one, briefly presented on our comments to Question 16), we advise that recommendations are more general, leaving each national regulator the authority to decide upon its course of action.

Nevertheless, it is important to state that the determination of different informational requirements for each jurisdiction might lead to cross-border unintended consequences, even if the "more general" approach is taken. For example, if foreign regulators set out requirements for differing sets of data/information, this could prompt local infrastructures to adapt their informational requirements to these sets rules, to allow securities lending operations in which one of the counterparties is a foreign person. This might provide for additional costs or, ultimately, prohibit cross border securities lending operations between agents in jurisdictions with substantially different requirements.

Appendix – Investment Funds classes and suffixes (cf. CVM Instruction n. 555)

Types of Investment Funds (Regulated by Instruction N° 555/2014 of the Brazilian Securities Commission (CVM) and later amendments)				
Classes	Risk Factor	Portfolio concentration limits by asset types	Suffix	Features
Fixed Income	Variation in domestic interest rates, price indexes, or both.	Minimum of 80% of the portfolio in assets related directly, or synthesized via derivatives, to the variation in the interest rates, price indexes, or both.	-	-
			Short Term	• Applies resources exclusively on: - Federal government or private debt (w/ low credit risk), fixed or indexed to the SELIC rate or any other interest rate, or securities linked to price indexes, with a maximum period of 375 days, and the average portfolio term of less than 60 days. - Quotas of index funds that invest in the assets above • Utilizes derivatives exclusively for hedging purposes • Realizes repo operations backed by federal government bonds.
			Long Term	By-laws must lay out commitment to obtain the tax treatment of long-term investment funds provided by the effective tax regulations (see section IV, below) and to comply with the conditions required
			Referenced	• Invests at least 95% of its Net Worth in assets that follow a benchmark, directly or indirectly • Has at least 80% of its Net Worth represented, individually or cumulatively, by: - Federal government debt - fixed income assets with low credit risk - Quotas of index funds that invest primarily in the assets above • Utilizes derivatives exclusively for the purpose of hedging the spot positions up to their limit.
			Simple	• Has at least 95% of its Net Worth represented, individually or cumulatively, by: - Federal government debt - fixed income assets issued by or co-obligation of financial institutions having credit rating assigned by the manager at least equivalent to Federal government debt, - repo operations, subject to certain conditions*: • Utilizes derivatives exclusively for hedging purposes • Is constituted as an open-end fund • By-laws establish that all documents and information related to the fund are available to the investors, preferably through electronic means
			External Debt	• Has at least 80% of its Net Worth invested in assets representative of the Federal government external debt.
			Private Credit	Invests in any assets or operational modalities of responsibility to individuals or private law entities†† or different public issuer of the Federal Government that exceed the percentage of 50% of its Net Worth, as a whole
Stock	Variation in stock prices traded in organized markets.	Minimum of 67% of the Net Worth composed by: stocks**, bonus, or subscription receipts** and share Certificates**, quotas of stock funds and stock indexes funds**, and levels II and III BDRs (Brazilian Depositary Receipts)	-	-
			Alternative Investment Market	Has at least 2/3 of the Net Worth invested in stocks of companies listed in the securities trading segment, focused on the access market, set by the stock exchange or entity of the organized over-the-counter market that holds, by contractual relationship, outstanding corporate governance practices***
			BDR – Level I	At least 67% of the Net Worth composed by the same assets of the stock fund, including level I BDRs

Foreign Exchange	Variation in foreign currency rates or variation in the foreign exchange coupon	Minimum of 80% of the portfolio in assets directly related, or synthesized through derivatives, via the variation in the foreign currency rates or in the foreign exchange coupon	-	-
Balanced/mixed	Various risk factors, without commitment to any particular factor or to factors different from other fund classes.	-	-	-
			Long Term	By-laws must lay out commitment to obtain the tax treatment of long-term investment funds provided by the effective tax regulations (see section IV, below) and to comply with the conditions required
			Private Credit	Invests in any asset or operation that is of responsibility of natural persons, private law entities†† or public issuers other than the Federal Government that, as a whole, exceed 50% of the fund's Net Worth.
Investment Fund Quotas	Depends	Minimum of 95% of its Net Worth invested in investment funds Quotas of a same class, except investments in funds classified as "balanced/mixed", which can invest in fund quotas belonging to different classes	-	-
Common suffixes				
All Classes		Investment Abroad†	Funds exclusively intended for professional or qualified investors without is no concentration limit to investments abroad.	
Specific Funds				
Specific Funds		Exclusive	Intended for a single professional investor	
		Social Security	Application in (i) Open-end and Closed-end private pension entities; (ii) Special Social Welfare Policy, established by Federal Government, States, Municipalities or the Federal District; (iii) Open-end private complementary pension plans and life insurance with survival coverage clause.	

Source: CVM Instruction n° 555/2014

* Repo operations pegged to Federal government debt or bonds issued with liability or joint liability of institutions authorized to operate by the BCB if, in operations backed by securities issued by private entities, the financial institution acting as a counterparty to the fund is assigned, by the fund manager, a risk rating at least equivalent to that of Federal government debt

** Admitted to trading in organized markets.

*** When constituted as a closed-end fund, these funds may invest up to 1/3 of their Net Worth in shares, debentures, subscription bonus or other bonds and securities convertible or exchangeable into closed company shares, subject to certain rules (§§ 6 to 12 of Article 115, CVM Instruction n° 555)

†Except for Foreign Exchange funds

††Except stocks**, bônus or subscription receipts ** and share Certificates**, quotas of stock funds and stock indexes funds**, and levels II and III BDRs (Brazilian Depositary Receipts)