FSB FINANCIAL STABILITY BOARD

Leverage in Non-Bank Financial Intermediation: Consultation report

Response to Consultation

Irish Funds Industry Association (Irish Funds)

Recommendation 1

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

   Irish Funds ("IF") would firstly note that the term 'NBFI' is overly broad given the number of actors within the financial ecosystem that it seeks to capture. As the representative association of the Irish funds industry our responses to this consultation should primarily be read in relation to investment funds and their fund managers. In fact, even the asset management and funds sector is hugely diverse with a wide range of strategies, investor bases, asset classes etc... This means a one-size-fits-all approach is not appropriate and the recommendations should remain principles-based.

   IF would agree, in general terms, with the description of financial stability risk arising from leverage as outlined by the FSB but also welcome the FSB acknowledgement that "Overall, these activities can enhance efficiency and support liquidity in financial markets" and that "leverage in NBFI may also play an important role in liquidity transformation". IF recognise that leverage can pose risk to financial stability if not managed properly and acknowledges that "the propagation of shocks through leverage occurs primarily via two channels: the position liquidation channel and the counterparty channel" and note the recognition of the risk of procyclicality.

   However, it is important to note that IF does not see individual funds as posing systemic risk through their leveraged positions. Indeed, we welcome the acknowledgement by the FSB that leverage is unevenly distributed in the NBFI sector, and particularly, "while insurance companies, pension funds and investment funds represent two-thirds of NBFI assets, most on-balance sheet financial leverage is in other non-bank financial entities". Equally, even though certain hedge fund ("HF") strategies are identified as having higher levels of synthetic risk, the FSB acknowledges that many HFs operate strategies with relatively low levels of leverage. Given this, Irish Fund would like to highlight that, using the standard Alternative Investment Fund Managers Directive ("AIFMD") regulatory measures, the European Securities and Markets Authority ("ESMA") Alternative Investment Fund ("AIF") Statistical Report shows that the average adjusted gross leverage in the AIF sector (including both 'financial' leverage and 'synthetic' leverage) was 139% at the end of 2020. However, this figure likely overstates the exposure of most alternative funds. From a European Union

("EU") domicile perspective, while the average adjusted gross leverage for hedge funds ("HFs") is 327%, it would not exceed an average of 141% for the other alternative fund categories. In fact, even within the hedge fund category, there are important disparities: "aggregate measures of leverage are upward biased due to extreme outliers: the median adjusted leverage for HFs remains around 120%, while the 10% highest levered HFs have a measure above 600%". As a result, the median of alternative investment funds has an adjusted gross leverage of only 102%, far below the AIF average. Ultimately, in the EU both the AIFMD and Undertakings for Collective Investment in Transferable Securities ("UCITS") frameworks have specific leverage requirements that should already meet the spirit of these FSB recommendations.

From a fund's perspective, it is important to recognise that leverage is not utilised just to increase exposure to a particular market (noting this is recognised more broadly in the consultation). Instead, funds will often use leverage for efficient portfolio management or risk management purposes. For example, funds may take on synthetic risk exposure through derivatives to hedge currency risk or to manage subscriptions. Therefore, IF would contend that leverage in and of itself is not a risk, instead it is a measure of borrowing levels to an entity's assets/equities. Additionally, IF does not believe that aggregating up leverage of individual investment vehicles or positions within a particular sector or across the financial system, will give an accurate indication of system-wide risks from leverage given the diverse nature of strategies and investor bases. While considering leverage at a funds level will provide some information regarding the fund this will not indicate systemic risk.

Therefore, in considering financial stability, IF would contend that policymakers, should firstly assess how risk transmits/interacts from core markets and/or systemically important institutions to the wider-financial system before undertaking to implement broader leverage-based measures. An assessment of this risk would allow more targeted interventions.

IF strongly support the goal of facilitating more meaningful monitoring of leverage for financial stability purposes. As such, IF would advocate for better data sharing among regulators to allow a more comprehensive view of the financial system. The key areas of risk must be identified first before any broad financial stability measures are implemented to ensure these do not have any unintended consequences of limiting the benefits of leverage (both trading and hedging risk), and actually deliver the benefits sought to both the markets and real economy. Therefore, it is critical that any FSB recommendations remain principles based.

Given the consultation references' to Archegos, IF will take the opportunity to advocate for measures to be extended to certain other NBFIs, such as these types of family offices, which can be less or (un)regulated and therefore may take on higher leverage without adequate controls. Indeed, the Archegos Capital Management case referenced in this consultation as a significant recent example of financial stability risks, arose at the interface of the banking system and a non-bank entity. As the case has been examined extensively, we would offer only two observations:

(i) that Archegos was a real test of the strengthened prudential and resolution framework for banks, which the framework was in general able to manage effectively; and

(ii) that opinions appear to vary among public authorities about whether the right supervisory data was available ex ante for policymakers to effectively monitor and assess Archegos' changing exposures and risk profile.

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

   It is noted that NBFI leverage comes in many forms (e.g. exposure through borrowing, exposure through derivatives etc.) and that leverage can be, and is, measured in many different ways by industry participants and authorities (e.g. Gross and commitment leverage under AIFMD, Global Exposure under UCITS, traditional loan-to-value metrics, etc.). Furthermore, these different forms of leverage and their measures can impact NBFIs in a myriad of ways depending upon the nature and structure (including recourse) of their investments.

   Authorities should therefore recognise that there is no one metric, or set of metrics, that can fully account for the idiosyncrasies of NBFIs and the information asymmetries that industry participants may be subject to.

   Risk metrics that attempt to capture multiple aspects of potential leverage are not instructive when it comes to monitoring financial stability risks. For example, gross leverage under AIFMD provides a single figure that does not provide clarity to the reader on what type of leverage the fund is exposed to e.g. it doesn't distinguish between leverage related to hedging and risk reduction versus leverage used to increase market exposure.

   Risk metrics can be more effective when calculating a specific sub-type of leverage exposure. However, this approach is frequently imperfect as a risk measure as it cannot account for the complexities and unique scenarios or structures utilised by NBFI participants. For example, for funds there needs to be a distinct separation across fund, asset type and strategy, in terms of leverage use, before any metrics can be considered. Therefore, a 'one size fits all' metric approach is not appropriate.

   Furthermore, the practical implications for authorities and market participants to implementing a specific measure of a sub-type of leverage may be burdensome and costly while not necessarily being instructive.

   IF maintain the fund manager is best placed (while adhering to the applicable regulatory frameworks their funds operate within) to measure and monitor leverage holistically across the fund while having the knowledge of the portfolio and investors to capture the unique exposures and any potential risk within the fund. To assist with this, we would support the development of feedback loops based on the data currently collected by regulators. This would provide valuable markets information, which ultimately will improve risk management processes, stress testing capabilities etc...

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

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

   Determining the most effective metrics for the monitoring of financial stability risks resulting from specific market activities, such as trading and investing in repos and derivatives, can be challenging due to the wide range of activities this can entail. While it is possible to take a "per instrument" type approach the result is likely to be i) burdensome; ii) complex; and iii) insufficiently flexible. It is our belief that the fund managers themselves are in the best position to measure and monitor leverage holistically across the fund while having the knowledge of the portfolio and underlying exposures to capture the unique exposures within the fund.

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

IF note that within this subcategory there is a very wide range of activities that can be undertaken and therefore are susceptible to the same limitations (re; applying specific metrics across such a complex and diverse ecosystem) as outlined previously. One additional point that often impacts such entities is the importance of considering net leverage figures. Certain strategies, for example volatility-arbitrage, can lend themselves to very large gross figures with net exposure being significantly smaller. Another example would be funds that invest in Interest Rate Swaps, as the prescribed notional calculation methodology under AIFMD results in excessively large notional gross exposures versus the actual underlying risk of the position

(iii) concentration and crowded trading strategies

The ability to monitor financial stability risks resulting from concentration and crowded trading strategies across multiple market participants, and possibly across geographies, represents a significant challenge. IF again reiterates that fund managers are themselves best place to monitor and manage their leverage exposure and also notes that it is imperative that leverage providers make themselves fully aware of the recourse and exposure in stressed conditions. From a market perspective, IF believe that considering a system-wide stress testing exercise similar to that performed by the Bank of England7 could help in this regard. This should be targeted in terms of areas of focus and intended outputs and proportionate in terms of supervisory and industry resources committed to such an initiative. Any stress testing exercise should only be viewed as a risk management tool, with any test having to be based on severe but plausible scenarios and not be used as a policy making tool. As our response outlines across the three questions, trying to isolate specific metrics across the NBFI sector would be extremely burdensome and complex. IF would highlight that there is already a significant amount of regulatory reporting in place. For example, in Europe funds with derivative exposures have specific reporting requirements under the European Market Infrastructure Regulation (“EMIR”), and it is our understanding that similar reporting requirements exist in other jurisdictions globally. Therefore, IF would urge regulators to consider ways to streamline the data they already receive from the various reporting regimes in place, reduce duplication and ensure better sharing of data between regulators in tandem with improved public reporting by regulators. A cost benefit analysis would need to be performed before any approach is agreed.

Recommendation 3

4. What types of publicly disclosed information (e.g. transaction volumes, outstanding amounts, aggregated regulatory data) are useful for market participants to enhance their liquidity or counterparty credit risk management? Are there trade-offs in publicly disclosing such information and, if so, what would be the most important elements to consider? What is the appropriate publication frequency and level of aggregation of publicly disclosed information?

IF would highlight that more broadly – and although not related directly to fund leverage – episodes such as the GameStop short squeeze in 2021 lend weight to arguments for less frequent data availability, since such events highlight an important risk dynamic (of signalling leading to stressed behaviour) which policymakers should seek to protect against. This could also be the case in concentrated markets, where an exit from the markets by a large investor could trigger herd behaviour if made public, thereby triggering a fire-sale in concentrated markets. Again, such behaviour would increase rather than reduce systemic risk. Ultimately, there should be a balance struck between the level of data made available and the potential negative impacts overly granular data requirements could create.

Recommendation 5

5. **Do Recommendations 4 and 5 sufficiently capture measures that would be used to address the scope of non-bank financial entities under consideration in this report? In what ways may the policy measures proposed in the consultation report need to be adjusted to account for different types of non-bank financial entities?**

   IF note that there is significant variation in the types of non-bank financial entities, and while the FSB acknowledges specific approaches may be needed for particular entities, for example entities investing in real estate assets, additional emphasis on calibration is required to avoid a 'one-size-fits-all' approach to what is an extremely diverse segment of the market, even at entity level.

   In relation to the objectives that policies seek to achieve, in Section 4.4 of the consultation report the FSB proposes that "Authorities should consider policy measures that align the incentives of non-bank financial entities with financial stability objectives". However, IF would highlight that many entities operating in the NBFI space are required by law and their constitutional documents to act in line with their fiduciary duty and in the best interests of their clients, rather than financial stability as an end goal per se. For example, in the EU, non-bank entities such as regulated open-ended investment funds are required to account for the impact of their activities on relevant markets and broader financial stability, and vice versa, through the implementation of an appropriate redemption policy, including the use of liquidity management tools. Mangers of such funds are also required to implement sound risk management practices which generally avoid excessive risk taking. However, managers of these funds are still required by law to operate in the best interest of their clients. As such, seeking to directly align private sector incentives with financial stability outcomes, as discussed in the FSB consultation paper, may not be appropriate. Rather it is the consideration of such outcomes within those entities' operations which is more appropriate. For example, in the EU, co-legislators recently revised the UCITSD/AIFMD frameworks to ensure that management companies across all Member States, in the operation of their UCITS and AIFs, have available for use a suite of liquidity and redemption management tools which seek to mitigate any potential first-mover advantage and ensure that the estimated costs of market liquidity are passed onto transacting investors. This is essential not only for the management of liquidity at a fund level but also for preventing the transmission of such risks to the broader financial system.

6. **In what circumstances can activity-based measures, such as (i) minimum haircuts in securities financing transactions, including government bond repos, (ii) enhanced margin requirements between non-bank financial entities and their derivatives counterparties, or (iii) central clearing, be effective in addressing financial stability risks related to NBFI leverage in core financial markets, including government bond markets? To what extent can these three types of policy measures complement each other?**

(i) It is not clear that implementing minimum haircuts in securities financing transactions ("SFTs"), including government bond repos, would reduce financial stability risks in related markets, per se. Rather, IF believe minimum haircuts could reduce incentives for entities to manage risk effectively. Typically, haircuts are seen as a method to manage counterparty risk. However, implementing minimum haircuts may actually create risk if not calibrated correctly or if the specifics of each market are not accounted for. As already referenced, leverage is widely used to hedge risk or match liabilities, all of which contribute to a well-functioning market. However, setting minimum haircuts could impact activity in some government bond markets, leading to increased borrowing costs and potentially impacting liquidity conditions (e.g. increased transaction costs, which leads to lower trading volumes and market liquidity).

(ii) Similarly, it is not clear that raising margin requirements would reduce financial stability risk in markets. IF believe increasing margin requirements could increase cost for entities to manage risk effectively (a cost which may ultimately be borne by the end-investor/client). It is also worth noting that it is equally important to ensure that brokers' collateral policies – including for investment funds – are sufficiently transparent to those investors that use their services, as we understand that brokers may impose additional margin requirements on their clients on top of those required by central counterparties (CCPs). Additionally, to alleviate unintended liquidity pressures from margin calls, we recommend expanding acceptable collaterals to include, for example, PDCNAV MMFs and certain qualifying ETFs.

(iii) IF is supportive of central clearing generally, however it may embed risks elsewhere, such as liquidity risk through requirements to post variation margin in cash (in addition to the initial margin). Increasing the number of transactions subject to mandatory clearing would increase liquidity demand and therefore, potentially liquidity risk. It may also increase risk in relation to the clearing entity itself, as this could bring concentration risk and, given the increased cost to the market, could preclude entry to the market of new smaller market participants and again concentrate the risk to fewer participants and create increased counterparty risk.

In conclusion, in our view it seems unlikely that implementing minimum haircuts and raising margin requirements on the same activities concurrently would be complementary. Rather, such actions could have a negative impact on entities' risk management practices, broader market functioning and liquidity, and returns for investors. Given this, IF would urge caution and advocate for a data-driven cost/benefit analysis before any of the proposed activity-based changes are introduced.

7. **Are there benefits to dynamic approaches to minimum margin and haircut requirements, e.g. where the requirements change based on changes in concentration or system-wide leverage? If so, what types of indicators capturing concentration or system-wide leverage should the requirements be linked to?**

Taking a dynamic approach to margining and haircuts would face several significant challenges:

1. Data - to avoid unintended consequences real-time robust data would be required across markets, as adjusting any risk sensitive frameworks requires detailed understanding of the composition, characteristics and complexities of each individual market.

2. Operational – we foresee significant operational challenges for market participants as dynamic margining would create uncertainty from a liquidity management perspective.

Therefore, IF would have strong concerns that dynamic approaches to minimum margin and haircut requirements would act procyclically to amplify potential risk in the financial system, rather than mitigate it. Attempting to dynamically manage margin and haircut requirements at a macro-level, within such a complex and risk-sensitive framework could have the unintended consequence of increasing costs and reducing liquidity. A regulator taking a dynamic approach to margining requirements would require a significant depth of data and knowledge (and the potential impacts) specific to each market. IF strongly advocates that it is the market participant who understands best the markets they deal in and therefore are most suited to managing the risk.

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

   As set out in our earlier responses, it is our view that activity-based measures could have negative impacts on an entities' risk management practices, broader market functioning, borrowing costs, liquidity, and returns for investors. This is in addition to potentially increased concentration risk (re; CCPs) highlighted in our response to question 6.

   IF believe that these potential unintended consequences have not been sufficiently considered by the FSB in its analysis of the impact of activity-based measures discussed in the consultation report.

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

   IF does not believe that minimum haircuts or margin requirements should be applied to non-centrally cleared SFTs (including government bond repos), as we do not believe it is appropriate for a regulator to set such requirements on an instrument-by-instrument basis. Not only would this be a burdensome undertaking (in particular if dynamic, per above), but our view is that an overly prescriptive and/or conservative approach would likely reduce the commercial viability of implementing certain risk-managed strategies. Regardless, in the context of margin practices, it is our understanding that non-centrally cleared trades executed in bilateral markets are governed by a robust regulatory framework, with prescriptive margin and reporting requirements and financial market participants are already required by regulators to produce a collateral policy and to update it on a regular basis.

10. **In what circumstances can entity-based measures, such as (i) direct and (ii) indirect leverage limits be effective in addressing financial stability risks related to NBFI leverage in core financial markets?**

   It should be recognised (in line with our response to question 2) that there are many different types of leverage calculation and forms of leverage, and their measures can impact NBFIs in a myriad of ways depending upon the nature and structure (including recourse) of their investments and strategies. An additional complexity in applying entity-level leverage limits is segregating those transactions that are used for hedging/risk management purposes and those focused on increasing returns.

   It is not clear that implementing direct leverage limits on entities would reduce financial stability risk in markets per se. Rather, introducing these measures may on the one hand potentially reduce risk in individual entities, but on the other could have potentially commensurate implications for investment returns, creating cliff-edge risks as entities see this as a new limit to manage to.

Imposing direct leverage limits on entities may also reduce flexibility in an entity's risk management framework. For particular asset types (e.g., real assets), this proposal could have unintended consequences by impacting underlying market functioning and liquidity. Therefore, there is a risk that leverage limits can cause forced-selling behaviours as entities approach this limit, exacerbating systemic risks. The same principle applies for any concentration and large exposure limits.

Additionally, implementing broad entity-level leverage limits is very challenging to implement, and could result in leverage being gained through less/unregulated areas in response to the imposition of such limits. This could lead to unregulated vehicles having greater capacity than regulated vehicles to acquire assets during times of stability and in turn, may cause depression of asset valuations in times of instability which affects regulated structures exposed to the same asset class. Direct leverage limits would negatively impact NBFIs while asset prices increased but not protect NBFIs if asset prices decrease. This may have the unintended consequence of reducing market liquidity.

Indirect leverage limits act through constraints on NBFIs' counterparties such as banks, prime brokers and central counterparties. Strengthened risk management practices by counterparties can reduce the probability of forced liquidations and fire sales, however, uniform implementation remains a significant challenge. Indirect leverage limits may create incentives for risk transfer to less regulated sectors. Similar to direct leverage limits, indirect leverage limits may disadvantage NBFIs compared to other borrowers in times of stability while not protecting NBFIs in the event that asset prices decreased. This may have the unintended consequence of reducing market liquidity.

IF would advocate, per our response to question 1, that policymakers should focus on systemically important core markets and/or institutions and firstly assess how risk may transmit/interact from these entities through the wider-financial system before undertaking to implement any leverage related measures. Identifying these risks will allow more targeted interventions. For example, the Central Bank of Ireland ("CBI") imposed leverage limits for Irish domiciled property funds under Article 25 of AIFMD following an assessment of risk in Ireland's real estate market.

The FSB discusses measures that authorities should consider in order to mitigate procyclicality, including the application of soft and hard direct/indirect leverage limits so as to allow for temporary breaches of soft limits during periods of stress. While this attempt to account for significant market shifts during periods of stress is welcome, market experience suggests that soft limits are often viewed by stakeholders, in any case, as hard limits and therefore there is still a risk of these limits herding segments of market participants to act in the same way, causing procyclical effects. Although not specifically leverage related, recent experience in money market funds (MMFs) highlights the potential procyclicality of implementing regulatory thresholds, in this case the (soft limit) regulatory link between liquidity and potential application of fees and gates. While a soft limit, the existence of the regulatory threshold had an impact on broader market participant behaviour with implications for financial stability. The FSB and other regulators globally have since proposed to remove this link within their respective MMF frameworks.

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

    The concern with implementing a top-down approach is that this may limit the diversity in the marketplace by constraining investment managers to a uniform approach. This in turn may limit the choice of investors with different risk profiles. Given the positive impacts that leverage can have (e.g. risk mitigation, helping in liquidity transformation), any leverage-related regulatory measure would need to be justified on financial stability grounds. For example, the idea of imposing indirect limits on the counterparties to NBFIs, such as banks or prime brokers, may be seen by some policymakers to align the financial incentives of lenders with financial stability, however Irish Fund's view is that it may decrease liquidity in the marketplace which may not ultimately contribute towards the goal of ensuring financial stability. It may also shift the source of leverage to less regulated, more opaque areas of the financial system.

    IF would also advocate that any interventions need to be targeted in nature, to address the specific financial stability concern and avoid unintended consequences to other areas of the market.

12. **Are there any potential unintended consequences from entity-based measures beyond those identified in the consultation report?**

    In terms of unintended consequences, IF does not believe that the FSB has sufficiently considered the potential impacts of implementing entity-based measures on underlying markets or market activity. For example, where leverage limits are implemented, they must be calibrated in such a way that does not unduly impact the functioning of underlying markets, and which avoids introducing (any further) procyclicality (see response to question 10). Therefore, we would strongly contend that a full risk assessment be undertaken before any leverage-based measures are considered.

    Furthermore, while the FSB mentions real estate limits being imposed in certain jurisdictions, it fails to mention that these limits are different per country and may be more favourable in certain jurisdictions, contrary to the principles of cross border passporting and harmonisation. Indeed, the CBI cites the potential unintended consequence (i.e., the volume of investment in the underlying asset class) as one of the "main" cost-benefit analysis issues when implementing such entity-based measures, alongside the potential for "leakage" (i.e., the

    domiciliation or moving of the underlying asset class to unregulated entities). Leverage constraints may also have the further unintended consequence of reduced profitability, which from an EU Savings and Investments Union ("SIU") perspective can impact inward investments into real assets and real estate. This together with over regulation through country specific limits and inconsistent oversight and application, may stifle the flow of private capital necessary for economic growth in certain jurisdictions.

    It should also be recognised that from a funds management perspective the leverage-based measures identified are more 'product' based as opposed to entity-based (e.g. LDI funds and Irish property funds). This is an important clarification as focusing on the 'entity' risks potentially ineffective measures being applied to specific firms given funds operate an 'Agency model'. This model is fundamental to the functioning of investment funds, as it establishes a framework of trust and accountability between the fund manager ('Agent') and investors (the 'principals'). The agency relationship carries a fiduciary duty, meaning that the fund manager has a legal and ethical obligation to act in the best interests of the investors. This duty includes making prudent investment decisions, managing risks, and disclosing relevant information to the investors. As such even with the failure of a fund manager the end investors are ringfenced and protected, i.e. liquidity calls on one investment fund will not put the manager or other investment funds at risk. However, IF does agree that any 'entity-based' measure should aim to avoid financial entities shifting risk across strategies and markets.

13. **To what extent can activity-based and entity-based measures complement each other? What are the main considerations around using these two types of measures in combination?**

    In principle, activity-based and entity-based measures can complement each other to the extent that the former affects the individual deals/instruments, and the latter impacts on the operations of each vehicle. The differing objectives of these measures, with activity-based measures more focused on credit/counterparty risk mitigation and entity-based measures more leverage-market driven, mean that their universal application across differing market participants can fail to account for the diverse nature of non-bank financial entities and their varying risk profiles.

    While positive in principle, our responses to other questions within this consultation response highlight:

    i) significant complexity in their reasonable calibration and implementation, giving rise to the challenge of implementing these measures universally and leading to the threat of regulatory arbitrage; and

    ii) potential procyclicality where the interaction between margin calls and leverage limits, in particular, may reduce market liquidity and increase volatility, all of which may amplify events of stress and potentially increase systemic risk.

    Finally, as referenced in other responses, IF would strongly contend that a full risk assessment be undertaken before any leverage-based measures are considered to avoid unintended consequences with the current FSB proposals.

Recommendation 6

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

    No Response.

Recommendation 7

15. **Would a minimum set of disclosures to be provided by leverage users to leverage providers be beneficial in improving counterparty credit risk management and reducing financial stability risks from NBFI leverage, including concentration risks? If so, which types of information and what level of granularity should (and should not) be included in this minimum set and why?**

IF agrees with policymakers that leverage providers require certain disclosures and information to measure and manage their exposures to highly leveraged counterparties. A prime broker's ability to measure financial stability risk from NBFI leverage depends on counterparty disclosure and cross-referencing with market-wide data. Ultimately, prime brokers must understand the markets for the securities they finance or take as collateral.

However, before policymakers consider imposing any additional disclosure requirements, it is Irish Funds understanding that prime brokers already receive financial information from NBFIs (e.g. AUM, level of leverage at fund level, investor profile, unencumbered cash etc…), this is in addition to supplementary data that is also available such as a fund's annual audited financial statements and Markets in Financial Instruments Directive ("MiFID") pre & post-trade transparency requirements. Therefore, the focus should be on first enforcing existing practices before new policies are introduced. IF would also strongly advocate against disclosure of actual positions at other prime brokers as this is commercially sensitive.

Irish Funds therefore contend that in many markets sufficient data is already available and that, in cases such as Archegos, the risk exposures from leverage are best managed by those providers of leverage.

Finally, IF would be cautioning against any recommendations that would restrict the number of prime brokers a fund manager can engage. Being able to access different prime brokers across jurisdictions enables managers to both leverage local expertise and diversify their risk exposures.

16. **What are the main impediments that leverage users face in sharing additional or more granular data with their leverage providers? Is there a risk that a minimum recommended set of disclosures may lead leverage users to limit the information they share with their leverage providers to that minimum set?**

IF welcomes the FSB's recognition that disclosures should be proportionate, risk-based and "allowing for proprietary client information to remain confidential". Ultimately, there has to be a balance struck between the benefits of more granular data being reported to leverage providers and the risk of disclosing commercially sensitive information. Only disclosures that are strictly necessary to manage leverage risk should be provided. Please also see the IF response to question 15.

17. **Should such a minimum set of disclosures rely on harmonised data and metrics to ensure transparency and efficiency in the use of such information for risk management purposes? Do respondents agree that such a minimum set of disclosures should be based on the list of principles outlined in the consultation report? If not, which principles should be added, deleted or amended?**

IF does not agree that disclosures should be based on the list of principles within the consultation report. We note the principles include that "Clients should provide aggregate information on their exposures across all entities or vehicles that are managed under a common strategy or decision-making process, to capture the impact of a coordinated liquidation across the client's full range of related investment products or vehicles". IF believe that requiring disclosure of positions at other prime brokers is essentially requiring the release of commercially sensitive information. This would represent a fundamental shift in market mechanics and could greatly curtail the number of prime brokers that NBFIs trade with, which would be a significant negative development as diversification of prime brokers is optimal for risk diversification.

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

    IF would contend that this is standard industry practice and that leverage providers already determine the information that they require from leverage users at the point of granting the leverage exposure/facility and on an ongoing basis. This information should be consistently required to aid with risk management within the leverage providers. Regular engagement between prime brokers and their counterparties also already exists and therefore they should be able to identify those counterparties that are facing liquidity challenges. As a result, IF would not see a need for a blanket mandate requiring enhanced reporting (in the case of a stress event) for all participants. Instead, we would advocate that the information being received, together with regular engagement, should be sufficient to flag potential issues. This approach would allow for a more efficient and targeted resolution of any issues. Indeed, mandating additional reporting for all firms to their leverage providers in times of stress is likely to lead to an information overload for prime brokers, diversion of firm resources that should be spent mitigating the risk and distracting from the management of those accounts that are actually at risk.

19. **Should authorities design a minimum set of harmonised disclosures and guidelines on its application, or should they convene a cross-industry working group to do so? How do respondents believe such a standard should be incorporated into market practice? Through regulation, supervisory guidance, and/or via a Code of Conduct or similar approach?**

    No Response.

Recommendation 8

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

    Due to the diverse nature of the financial ecosystem, the principle of 'same risk, same regulatory treatment' would be difficult to implement, and does not appear to appreciate either the diversity of the term 'risk' or the robust regulatory environment that funds already operate in.

    Even within the funds sector risks will vary i.e. if multiple funds hold the same security, they are subject to the same investment risk but not subject to the same entity/product risk. For example, the level of equity or the redemption rights offered to investors will vary by fund and therefore the risk impact will be different. EU regulated funds are already governed by the well-tested and robust AIFMD/UCITS frameworks, with both having been reviewed and updated, with significant work ongoing around liquidity management, and enhanced reporting as a result. Therefore, IF would have concerns that this principle may lead to an unnecessary and/or unsuitable overlay of regulation. Equally, from an entity perspective the 'agency' model that governs funds means that the losses/shocks to an individual fund/investment will have a different impact than it would for other financial market participants.

    In terms of leverage specifically, both UCITS and AIFs are currently subject to certain leverage restrictions, risk management requirements and/or scrutiny through both vehicle specific and diversification limits (in the case of UCITS), supervisory reporting (e.g. there is enhanced reporting requirements for AIFs where leverage >300%), public disclosures, along with supervision and enforcement powers held by the relevant authorities. As acknowledged in this consultation, leverage in funds is typically low and therefore IF would be reluctant for further overlays to be introduced for funds to solve perceived weaknesses in other areas of the financial system. So, while we welcome the recognition that "Congruent treatment should not imply identical treatment", and "authorities should have regard to the specific characteristics of different entities" (along with their regulatory requirements), concerns remain that by applying further regulatory restrictions on funds could have unintended consequences.

Furthermore, IF does not believe that movement of positions from central clearing to bilateral markets (for products not subject to mandatory clearing) breaches the principle of 'same risk, same regulatory treatment'. We would contend that non-centrally cleared trades executed in bilateral markets are subject to a robust regulatory framework (prescriptive margin and regulatory reporting), and the flexibility with regards to collateral posting under their credit support agreements can act as a risk mitigant, preventing procyclical deleveraging during periods of liquidity stress.

Ultimately, IF is supportive of greater regulatory collaboration and information sharing between regulators and authorities to ensure that any potential risk is scrutinised carefully before additional measures are introduced but would not be supportive of bank-like macroprudential measures being applied to funds.

Introduction

The Irish Funds Industry Association (Irish Funds) is the representative body for the international investment funds industry in Ireland. Our members include fund managers, fund administrators, transfer agents, depositaries, professional advisory firms, and other specialist firms involved in the international fund services industry in Ireland. By enabling global investment managers to deploy capital around the world for the benefit of internationally based investors, we support saving and investing across economies. Ireland is a leading location in Europe and globally for the domiciling and administration of investment funds. The funds industry employs over 19,519 professionals across every county in Ireland, with over 37,468 of a total employment impact right across the country[1] and provide services to almost 8,900 Irish regulated investment funds with assets of just under EUR 5 trillion[2].

[1] Assessment of the impact of the Funds & Asset Management Industry on the Irish Economy, Indecon, 2024
[2] Central Bank of Ireland, November 2024.

Leverage in Non-bank Financial Intermediation

Recommendation 1: Authorities should have a domestic framework to identify and monitor vulnerabilities related to NBFI leverage and associated financial stability risks in an effective, frequent and timely manner. The domestic framework should be proportionate to the financial stability risks that such vulnerabilities may pose, particularly in core financial markets. Authorities should regularly review their domestic framework and enhance it as appropriate, including the risk metrics utilised, and take steps to improve international consistency in the definition and calculation of those metrics.

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

Irish Funds ("IF") would firstly note that the term 'NBFI' is overly broad given the number of actors within the financial ecosystem that it seeks to capture. As the representative association of the Irish funds industry our responses to this consultation should primarily be read in relation to investment funds and their fund managers. In fact, even the asset management and funds sector is hugely diverse with a wide range of strategies, investor bases, asset classes etc... This means a one-size-fits-all approach is not appropriate and the recommendations should remain principles-based.

IF would agree, in general terms, with the description of financial stability risk arising from leverage as outlined by the FSB but also welcome the FSB acknowledgement that "*Overall, these activities can enhance efficiency and support liquidity in financial markets*" and that "*leverage in NBFI may also play an important role in liquidity transformation*". IF recognise that leverage can pose risk to financial stability if not managed properly and acknowledges that "*the propagation of shocks through leverage occurs primarily via two channels: the position liquidation channel and the counterparty channel*" and note the recognition of the risk of procyclicality.

However, it is important to note that IF does not see individual funds as posing systemic risk through their leveraged positions. Indeed, we welcome the acknowledgement by the FSB that leverage is unevenly distributed in the NBFI sector, and particularly, "*while insurance companies, pension funds and investment funds represent two-thirds of NBFI assets, most on-balance sheet financial leverage is in other non-bank financial entities*". Equally, even though certain hedge fund ("HF") strategies are identified as having higher levels of synthetic risk, the FSB acknowledges that many HFs operate strategies with relatively low levels of leverage. Given this, Irish Fund would like to highlight that, using the standard Alternative Investment Fund Managers Directive ("AIFMD") regulatory measures, the European Securities and Markets Authority ("ESMA") Alternative Investment Fund ("AIF") Statistical Report[3] shows that the average adjusted gross leverage in the AIF sector (including both 'financial' leverage and 'synthetic' leverage) was 139% at the end of 2020. However, this figure likely overstates the exposure of most alternative funds. From a European Union ("EU") domicile perspective, while the average adjusted gross leverage for hedge funds ("HFs") is 327%, it would not exceed an average of 141% for the other alternative fund categories. In fact, even within the hedge fund category, there are important disparities: "*aggregate measures of leverage are upward biased due to extreme outliers: the median adjusted leverage for HFs remains around 120%, while the 10% highest levered HFs have a measure above 600%*[4]". As a result, the median of alternative investment funds has an adjusted gross

[3] ESMA, AIF Statistical Report, February 2022, pp. 6.
[4] ESMA, AIF Statistical Report, February 2022, pp. 13.

leverage of only 102%, far below the AIF average[5]. Ultimately, in the EU both the AIFMD and Undertakings for Collective Investment in Transferable Securities ("UCITS") frameworks have specific leverage requirements that should already meet the spirit of these FSB recommendations.

From a fund's perspective, it is important to recognise that leverage is not utilised just to increase exposure to a particular market (noting this is recognised more broadly in the consultation). Instead, funds will often use leverage for efficient portfolio management or risk management purposes. For example, funds may take on synthetic risk exposure through derivatives to hedge currency risk or to manage subscriptions. Therefore, IF would contend that leverage in and of itself is not a risk, instead it is a measure of borrowing levels to an entity's assets/equities. Additionally, IF does not believe that aggregating up leverage of individual investment vehicles or positions within a particular sector or across the financial system, will give an accurate indication of system-wide risks from leverage given the diverse nature of strategies and investor bases. While considering leverage at a funds level will provide some information regarding the fund this will not indicate systemic risk.

Therefore, in considering financial stability, IF would contend that policymakers, should firstly assess how risk transmits/interacts from core markets and/or systemically important institutions to the wider-financial system before undertaking to implement broader leverage-based measures. An assessment of this risk would allow more targeted interventions.

IF strongly support the goal of facilitating more meaningful monitoring of leverage for financial stability purposes. As such, IF would advocate for better data sharing among regulators to allow a more comprehensive view of the financial system. The key areas of risk must be identified first before any broad financial stability measures are implemented to ensure these do not have any unintended consequences of limiting the benefits of leverage (both trading and hedging risk), and actually deliver the benefits sought to both the markets and real economy. Therefore, it is critical that any FSB recommendations remain principles based.

Given the consultation references' to Archegos, IF will take the opportunity to advocate for measures to be extended to certain other NBFIs, such as these types of family offices, which can be less or (un)regulated and therefore may take on higher leverage without adequate controls. Indeed, the Archegos Capital Management case referenced in this consultation as a significant recent example of financial stability risks, arose at the interface of the banking system and a non-bank entity. As the case has been examined extensively, we would offer only two observations:

(i) that Archegos was a real test of the strengthened prudential and resolution framework for banks, which the framework was in general able to manage effectively; and

(ii) that opinions appear to vary among public authorities about whether the right supervisory data was available ex ante for policymakers to effectively monitor and assess Archegos' changing exposures and risk profile.

[5] ESMA, TRV Report, September 2021, pp. 27-28.

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

It is noted that NBFI leverage comes in many forms (e.g. exposure through borrowing, exposure through derivatives etc.) and that leverage can be, and is, measured in many different ways by industry participants and authorities (e.g. Gross and commitment leverage under AIFMD, Global Exposure under UCITS, traditional loan-to-value metrics, etc.). Furthermore, these different forms of leverage and their measures can impact NBFIs in a myriad of ways depending upon the nature and structure (including recourse) of their investments.

Authorities should therefore recognise that there is no one metric, or set of metrics, that can fully account for the idiosyncrasies of NBFIs and the information asymmetries that industry participants may be subject to.

Risk metrics that attempt to capture multiple aspects of potential leverage are not instructive when it comes to monitoring financial stability risks. For example, gross leverage under AIFMD provides a single figure that does not provide clarity to the reader on what type of leverage the fund is exposed to e.g. it doesn't distinguish between leverage related to hedging and risk reduction versus leverage used to increase market exposure.

Risk metrics can be more effective when calculating a specific *sub-type* of leverage exposure. However, this approach is frequently imperfect as a risk measure as it cannot account for the complexities and unique scenarios or structures utilised by NBFI participants. For example, for funds there needs to be a distinct separation across fund, asset type and strategy, in terms of leverage use, before any metrics can be considered. Therefore, a 'one size fits all' metric approach is not appropriate.

Furthermore, the practical implications for authorities and market participants to implementing a specific measure of a sub-type of leverage may be burdensome and costly while not necessarily being instructive.

IF maintain the fund manager is best placed (while adhering to the applicable regulatory frameworks their funds operate within) to measure and monitor leverage holistically across the fund while having the knowledge of the portfolio and investors to capture the unique exposures and any potential risk within the fund. To assist with this, we would support the development of feedback loops based on the data currently collected by regulators. This would provide valuable markets information, which ultimately will improve risk management processes, stress testing capabilities etc...

3. What are the most effective metrics for the monitoring of financial stability risks resulting from
(i) specific market activities, such as trading and investing in repos and derivatives?
(ii) specific types of entities, such as hedge funds, other leveraged investment funds, insurance companies and pension funds?
(iii) concentration and crowded trading strategies?

(i) Determining the most effective metrics for the monitoring of financial stability risks resulting from specific market activities, such as trading and investing in repos and derivatives, can be challenging due to the wide range of activities this can entail. While it is possible to take a "per instrument" type approach the result is likely to be i) burdensome; ii) complex; and iii) insufficiently flexible. It is our belief that the fund managers themselves are in the best position to measure and monitor leverage holistically across the fund while having the knowledge of the portfolio and underlying exposures to capture the unique exposures within the fund.

(ii) IF note that within this subcategory there is a very wide range of activities that can be undertaken and therefore are susceptible to the same limitations (re; applying specific metrics across such a complex and diverse ecosystem) as outlined previously. One additional point that often impacts such entities is the importance of considering net leverage figures. Certain strategies, for example volatility-arbitrage, can lend themselves to very large gross figures with net exposure being significantly smaller. Another example would be funds that invest in Interest Rate Swaps, as the prescribed notional calculation methodology under AIFMD results in excessively large notional gross exposures versus the actual underlying risk of the position[6].

(iii) The ability to monitor financial stability risks resulting from concentration and crowded trading strategies across multiple market participants, and possibly across geographies, represents a significant challenge. IF again reiterates that fund managers are themselves best place to monitor and manage their leverage exposure and also notes that it is imperative that leverage providers make themselves fully aware of the recourse and exposure in stressed conditions.

From a market perspective, IF believe that considering a system-wide stress testing exercise similar to that performed by the Bank of England[7] could help in this regard. This should be targeted in terms of areas of focus and intended outputs and proportionate in terms of supervisory and industry resources committed to such an initiative. Any stress testing exercise should only be viewed as a risk management tool, with any test having to be based on severe but plausible scenarios and not be used as a policy making tool.

As our response outlines across the three questions, trying to isolate specific metrics across the NBFI sector would be extremely burdensome and complex. IF would highlight that there is already a significant amount of regulatory reporting in place. For example, in Europe funds with derivative exposures have specific reporting requirements under the European Market Infrastructure Regulation ("EMIR"), and it is our understanding that similar reporting requirements exist in other jurisdictions globally. Therefore, IF would urge regulators to consider ways to streamline the data they already receive from the various reporting regimes in place, reduce duplication and ensure better sharing of data between regulators in tandem with improved public reporting by regulators. A cost benefit analysis would need to be performed before any approach is agreed.

Recommendation 3: Authorities should review the level of granularity, frequency, and timeliness of existing public disclosures and determine the degree to which additional or enhanced disclosures should be provided to the public, either by (i) authorities, including disclosure based on regulatory reporting data, (ii) the relevant financial market infrastructure providers or (iii) directly by financial entities, balancing the costs and benefits of doing so. This includes dissemination by authorities of data and information on aggregate market positioning and transaction volumes based on existing regulatory reporting. Such additional or enhanced disclosures should be designed and calibrated to increase transparency especially about concentration risk and crowdedness, with the aim to support market participants' ability to manage risks from NBFI leverage and estimate counterparty exposures and liquidation costs.

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

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[6] It is well recognised that the gross leverage figure (under AIFMD) is not an accurate measure of the true leverage of a fund given it does not consider netting or hedging arrangements. However, it is worth noting that even the 'commitment' approach has netting limitations, with various netting arrangements only being applied in certain cases and as such it is a more complex calculation that is difficult to automate. Therefore, restrictions in what you can net using this method may also indicate higher levels of leverage than is actually the case.

[7] See Bank of England, SWES Final Report, 29 November 2024

disclosing such information and, if so, what would be the most important elements to consider? What is the appropriate publication frequency and level of aggregation of publicly disclosed information?

IF would highlight that more broadly – and although not related directly to fund leverage – episodes such as the GameStop short squeeze in 2021 lend weight to arguments for less frequent data availability, since such events highlight an important risk dynamic (of signalling leading to stressed behaviour) which policymakers should seek to protect against. This could also be the case in concentrated markets, where an exit from the markets by a large investor could trigger herd behaviour if made public, thereby triggering a fire-sale in concentrated markets. Again, such behaviour would increase rather than reduce systemic risk. Ultimately, there should be a balance struck between the level of data made available and the potential negative impacts overly granular data requirements could create.

Recommendation 4: Authorities should take steps to address the financial stability risks from NBFI leverage that they identify in core financial markets. Activity-based and entity-based measures and measures aimed at addressing concentration that amplifies risks related to NBFI leverage, should be reviewed periodically and enhanced where appropriate, including to address risks from a system wide perspective. The measures should be selected and calibrated to be effective and proportionate to the identified financial stability risks. Where existing legal and regulatory frameworks do not provide the necessary policy measures to address identified financial stability risks, authorities should consider adjusting or widening the scope of such frameworks, where appropriate.

AND

Recommendation 5: When selecting policy measures to address financial stability risks from NBFI leverage in core financial markets, authorities should evaluate a wide range of measures, including both activity and entity-based measures, as well as concentration related measures. Authorities' choice of measures should be based on the nature and drivers of identified risks, taking into account their expected effectiveness and any potential costs or unintended consequences, as well as measures taken in other jurisdictions to address similar risks. Activity-based measures include (i) minimum haircuts in SFTs, including government bond repos, (ii) enhanced margining requirements between non-bank financial entities and their derivatives counterparties, and (iii) central clearing mandates in SFT and derivatives markets. Entity-based measures include (i) direct limits on leverage, and (ii) indirect leverage constraints linked to risks that non-bank financial entities are exposed to. Concentration measures include (i) concentration add-ons for margins and haircuts in connection with exposures of non-bank financial entities in derivatives and SFT markets, (ii) concentration and large exposure limits, and (iii) large position reporting requirements.

5. Do Recommendations 4 and 5 sufficiently capture measures that would be used to address the scope of non-bank financial entities under consideration in this report? In what ways may the policy measures proposed in the consultation report need to be adjusted to account for different types of non-bank financial entities?

IF note that there is significant variation in the types of non-bank financial entities, and while the FSB acknowledges specific approaches may be needed for particular entities, for example entities investing in real estate assets, additional emphasis on calibration is required to avoid a 'one-size-fits-all' approach to what is an extremely diverse segment of the market, even at entity level.

In relation to the objectives that policies seek to achieve, in Section 4.4 of the consultation report the FSB proposes that "*Authorities should consider policy measures that align the* *incentives of non-bank financial entities with financial stability objectives"*. However, IF would highlight that many entities operating in the NBFI space are required by law and their constitutional documents to act in line with their fiduciary duty and in the best interests of their clients, rather than financial stability as an end goal per se. For example, in the EU, non-bank entities such as regulated open-ended investment funds are required to account for the impact of their activities on relevant markets and broader financial stability, and vice versa, through the implementation of an appropriate redemption policy, including the use of liquidity management tools. Mangers of such funds are also required to implement sound risk management practices which generally avoid excessive risk taking. However, managers of these funds are still required by law to operate in the best interest of their clients. As such, seeking to directly align private sector incentives with financial stability outcomes, as discussed in the FSB consultation paper, may not be appropriate. Rather it is the consideration of such outcomes within those entities' operations which is more appropriate. For example, in the EU, co-legislators recently revised the UCITSD/AIFMD frameworks to ensure that management companies across all Member States, in the operation of their UCITS and AIFs, have available for use a suite of liquidity and redemption management tools which seek to mitigate any potential first-mover advantage and ensure that the estimated costs of market liquidity are passed onto transacting investors. This is essential not only for the management of liquidity at a fund level but also for preventing the transmission of such risks to the broader financial system.

6. In what circumstances can activity-based measures, such as (i) minimum haircuts in securities financing transactions, including government bond repos, (ii) enhanced margin requirements between non-bank financial entities and their derivatives counterparties, or (iii) central clearing, be effective in addressing financial stability risks related to NBFI leverage in core financial markets, including government bond markets? To what extent can these three types of policy measures complement each other?

(i) It is not clear that implementing minimum haircuts in securities financing transactions ("SFTs"), including government bond repos, would reduce financial stability risks in related markets, per se. Rather, IF believe minimum haircuts could reduce incentives for entities to manage risk effectively. Typically, haircuts are seen as a method to manage counterparty risk. However, implementing minimum haircuts may actually create risk if not calibrated correctly or if the specifics of each market are not accounted for. As already referenced, leverage is widely used to hedge risk or match liabilities, all of which contribute to a well-functioning market. However, setting minimum haircuts could impact activity in some government bond markets, leading to increased borrowing costs and potentially impacting liquidity conditions (e.g. increased transaction costs, which leads to lower trading volumes and market liquidity).

(ii) Similarly, it is not clear that raising margin requirements would reduce financial stability risk in markets. IF believe increasing margin requirements could increase cost for entities to manage risk effectively (a cost which may ultimately be borne by the end-investor/client). It is also worth noting that it is equally important to ensure that brokers' collateral policies – including for investment funds – are sufficiently transparent to those investors that use their services, as we understand that brokers may impose additional margin requirements on their clients on top of those required by central counterparties (CCPs). Additionally, to alleviate unintended liquidity pressures from margin calls, we recommend expanding acceptable collaterals to include, for example, PDCNAV MMFs and certain qualifying ETFs.

(iii) IF is supportive of central clearing generally, however it may embed risks elsewhere, such as liquidity risk through requirements to post variation margin in cash (in addition to the initial margin). Increasing the number of transactions subject to mandatory clearing would increase liquidity demand and therefore, potentially liquidity risk. It may also increase risk in relation to the clearing entity itself, as this could bring concentration risk and, given the increased cost to the market, could preclude entry to the market of new smaller market participants and again concentrate the risk to fewer participants and create increased counterparty risk.

In conclusion, in our view it seems unlikely that implementing minimum haircuts and raising margin requirements on the same activities concurrently would be complementary. Rather, such actions could have a negative impact on entities' risk management practices, broader market functioning and liquidity, and returns for investors. Given this, IF would urge caution and advocate for a data-driven cost/benefit analysis before any of the proposed activity-based changes are introduced.

7. Are there benefits to dynamic approaches to minimum margin and haircut requirements, e.g. where the requirements change based on changes in concentration or system-wide leverage? If so, what types of indicators capturing concentration or system-wide leverage should the requirements be linked to?

Taking a dynamic approach to margining and haircuts would face several significant challenges:

1. Data - to avoid unintended consequences real-time robust data would be required across markets, as adjusting any risk sensitive frameworks requires detailed understanding of the composition, characteristics and complexities of each individual market.
2. Operational – we foresee significant operational challenges for market participants as dynamic margining would create uncertainty from a liquidity management perspective.

Therefore, IF would have strong concerns that dynamic approaches to minimum margin and haircut requirements would act procyclically to amplify potential risk in the financial system, rather than mitigate it. Attempting to dynamically manage margin and haircut requirements at a macro-level, within such a complex and risk-sensitive framework could have the unintended consequence of increasing costs and reducing liquidity. A regulator taking a dynamic approach to margining requirements would require a significant depth of data and knowledge (and the potential impacts) specific to each market. IF strongly advocates that it is the market participant who understands best the markets they deal in and therefore are most suited to managing the risk.

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

As set out in our earlier responses, it is our view that activity-based measures could have negative impacts on an entities' risk management practices, broader market functioning, borrowing costs, liquidity, and returns for investors. This is in addition to potentially increased concentration risk (re; CCPs) highlighted in our response to question 6.

IF believe that these potential unintended consequences have not been sufficiently considered by the FSB in its analysis of the impact of activity-based measures discussed in the consultation report.

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

IF does not believe that minimum haircuts or margin requirements should be applied to non-centrally cleared SFTs (including government bond repos), as we do not believe it is appropriate for a regulator to set such requirements on an instrument-by-instrument basis. Not only would this be a burdensome undertaking (in particular if dynamic, per above), but our view is that an overly prescriptive and/or conservative approach would likely reduce the commercial viability of implementing certain risk-managed strategies. Regardless, in the context of margin practices, it is our understanding that non-centrally cleared trades executed in bilateral markets are governed by a robust regulatory framework, with prescriptive margin and reporting requirements and financial market participants are already required by regulators to produce a collateral policy and to update it on a regular basis.

10. In what circumstances can entity-based measures, such as (i) direct and (ii) indirect leverage limits be effective in addressing financial stability risks related to NBFI leverage in core financial markets?

It should be recognised (in line with our response to question 2) that there are many different types of leverage calculation and forms of leverage, and their measures can impact NBFIs in a myriad of ways depending upon the nature and structure (including recourse) of their investments and strategies. An additional complexity in applying entity-level leverage limits is segregating those transactions that are used for hedging/risk management purposes and those focused on increasing returns.

It is not clear that implementing direct leverage limits on entities would reduce financial stability risk in markets per se. Rather, introducing these measures may on the one hand potentially reduce risk in individual entities, but on the other could have potentially commensurate implications for investment returns, creating cliff-edge risks as entities see this as a new limit to manage to.

Imposing direct leverage limits on entities may also reduce flexibility in an entity's risk management framework. For particular asset types (e.g., real assets), this proposal could have unintended consequences by impacting underlying market functioning and liquidity. Therefore, there is a risk that leverage limits can cause forced-selling behaviours as entities approach this limit, exacerbating systemic risks. The same principle applies for any concentration and large exposure limits.

Additionally, implementing broad entity-level leverage limits is very challenging to implement, and could result in leverage being gained through less/unregulated areas in response to the imposition of such limits. This could lead to unregulated vehicles having greater capacity than regulated vehicles to acquire assets during times of stability and in turn, may cause depression of asset valuations in times of instability which affects regulated structures exposed to the same asset class. Direct leverage limits would negatively impact NBFIs while asset prices increased but not protect NBFIs if asset prices decrease. This may have the unintended consequence of reducing market liquidity.

Indirect leverage limits act through constraints on NBFIs' counterparties such as banks, prime brokers and central counterparties. Strengthened risk management practices by counterparties can reduce the probability of forced liquidations and fire sales, however, uniform implementation remains a significant challenge. Indirect leverage limits may create incentives for risk transfer to less regulated sectors. Similar to direct leverage limits, indirect leverage limits may disadvantage NBFIs compared to other borrowers in times of stability while not protecting NBFIs in the event that asset prices decreased. This may have the unintended consequence of reducing market liquidity.

IF would advocate, per our response to question 1, that policymakers should focus on systemically important core markets and/or institutions and firstly assess how risk may transmit/interact from these entities through the wider-financial system before undertaking to implement any leverage related measures. Identifying these risks will allow more targeted interventions. For example, the Central Bank of Ireland ("CBI") imposed leverage limits for Irish domiciled property funds under Article 25 of AIFMD following an assessment of risk in Ireland's real estate market.

The FSB discusses measures that authorities should consider in order to mitigate procyclicality, including the application of soft and hard direct/indirect leverage limits so as to allow for temporary breaches of soft limits during periods of stress. While this attempt to account for significant market shifts during periods of stress is welcome, market experience suggests that soft limits are often viewed by stakeholders, in any case, as hard limits and therefore there is still a risk of these limits herding segments of market participants to act in the same way, causing procyclical effects. Although not specifically leverage related, recent experience in money market funds (MMFs) highlights the potential procyclicality of implementing regulatory thresholds, in this case the (soft limit) regulatory link between liquidity and potential application of fees and gates. While a soft limit, the existence of the regulatory threshold had an impact on broader market participant behaviour with implications for financial stability. The FSB and other regulators globally have since proposed to remove this link within their respective MMF frameworks[8].

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

The concern with implementing a top-down approach is that this may limit the diversity in the marketplace by constraining investment managers to a uniform approach. This in turn may limit the choice of investors with different risk profiles. Given the positive impacts that leverage can have (e.g. risk mitigation, helping in liquidity transformation), any leverage-related regulatory measure would need to be justified on financial stability grounds. For example, the idea of imposing indirect limits on the counterparties to NBFIs, such as banks or prime brokers, may be seen by some policymakers to align the financial incentives of lenders with financial stability, however Irish Fund's view is that it may decrease liquidity in the marketplace which may not ultimately contribute towards the goal of ensuring financial stability. It may also shift the source of leverage to less regulated, more opaque areas of the financial system.

IF would also advocate that any interventions need to be targeted in nature, to address the specific financial stability concern and avoid unintended consequences to other areas of the market.

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

In terms of unintended consequences, IF does not believe that the FSB has sufficiently considered the potential impacts of implementing entity-based measures on underlying markets or market activity. For example, where leverage limits are implemented, they must be calibrated in such a way that does not unduly impact the functioning of underlying markets, and which avoids introducing (any further) procyclicality (see response to question 10). Therefore, we would strongly contend that a full risk assessment be undertaken before any leverage-based measures are considered.

Furthermore, while the FSB mentions real estate limits being imposed in certain jurisdictions, it fails to mention that these limits are different per country and may be more favourable in certain jurisdictions, contrary to the principles of cross border passporting and harmonisation. Indeed, the CBI cites the potential unintended consequence (i.e., the volume of investment in the underlying asset class) as one of the "main" cost-benefit analysis issues when implementing such entity-based measures, alongside the potential for "leakage" (i.e., the

[8] FSB, Final Report: Policy Proposals to Enhance Money Market Fund Resilience, October 2021;
ESMA, Final Report: ESMA opinion on the review of the Money Market Fund Regulation, February 2022; and
FCA, Consultation Paper (CP23/28): Updating the regime for Money Market Funds, December 2023

domiciliation or moving of the underlying asset class to unregulated entities)[9]. Leverage constraints may also have the further unintended consequence of reduced profitability, which from an EU Savings and Investments Union ("SIU") perspective can impact inward investments into real assets and real estate. This together with over regulation through country specific limits and inconsistent oversight and application, may stifle the flow of private capital necessary for economic growth in certain jurisdictions.

It should also be recognised that from a funds management perspective the leverage-based measures identified are more 'product' based as opposed to entity-based (e.g. LDI funds and Irish property funds). This is an important clarification as focusing on the 'entity' risks potentially ineffective measures being applied to specific firms given funds operate an 'Agency model'. This model is fundamental to the functioning of investment funds, as it establishes a framework of trust and accountability between the fund manager ('Agent') and investors (the 'principals'). The agency relationship carries a fiduciary duty, meaning that the fund manager has a legal and ethical obligation to act in the best interests of the investors. This duty includes making prudent investment decisions, managing risks, and disclosing relevant information to the investors. As such even with the failure of a fund manager the end investors are ringfenced and protected, i.e. liquidity calls on one investment fund will not put the manager or other investment funds at risk. However, IF does agree that any 'entity-based' measure should aim to avoid financial entities shifting risk across strategies and markets.

13. To what extent can activity-based and entity-based measures complement each other? What are the main considerations around using these two types of measures in combination?

In principle, activity-based and entity-based measures can complement each other to the extent that the former affects the individual deals/instruments, and the latter impacts on the operations of each vehicle. The differing objectives of these measures, with activity-based measures more focused on credit/counterparty risk mitigation and entity-based measures more leverage-market driven, mean that their universal application across differing market participants can fail to account for the diverse nature of non-bank financial entities and their varying risk profiles.

While positive in principle, our responses to other questions within this consultation response highlight:
i) significant complexity in their reasonable calibration and implementation, giving rise to the challenge of implementing these measures universally and leading to the threat of regulatory arbitrage; and
ii) potential procyclicality where the interaction between margin calls and leverage limits, in particular, may reduce market liquidity and increase volatility, all of which may amplify events of stress and potentially increase systemic risk.

Finally, as referenced in other responses, IF would strongly contend that a full risk assessment be undertaken before any leverage-based measures are considered to avoid unintended consequences with the current FSB proposals.

[9] Central Bank of Ireland, The Central Bank's macroprudential policy framework for Irish property funds, November 2022

Recommendation 6: Authorities should ensure the timely and thorough implementation of the BCBS's guidelines on counterparty credit risk which represents an important element of a comprehensive policy response to financial stability risks stemming from NBFI leverage. Authorities, in cooperation with SSBs, should monitor, including from a systemic perspective, ongoing and future developments in the way NBFI leverage is provided to ensure that the regulatory framework remains appropriate for the consistent treatment of risks.

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

No Response.

Recommendation 7: Authorities, in cooperation with SSBs, should review the adequacy of existing private disclosure practices between leveraged non-bank financial entities and leverage providers, including the level of granularity, frequency, and timeliness of such practices. Where appropriate, they should consider developing mechanisms and/or minimum standards to enhance the effectiveness of these disclosure practices.

15. Would a minimum set of disclosures to be provided by leverage users to leverage providers be beneficial in improving counterparty credit risk management and reducing financial stability risks from NBFI leverage, including concentration risks? If so, which types of information and what level of granularity should (and should not) be included in this minimum set and why?

IF agrees with policymakers that leverage providers require certain disclosures and information to measure and manage their exposures to highly leveraged counterparties. A prime broker's ability to measure financial stability risk from NBFI leverage depends on counterparty disclosure and cross-referencing with market-wide data. Ultimately, prime brokers must understand the markets for the securities they finance or take as collateral.

However, before policymakers consider imposing any additional disclosure requirements, it is Irish Funds understanding that prime brokers already receive financial information from NBFIs (e.g. AUM, level of leverage at fund level, investor profile, unencumbered cash etc…), this is in addition to supplementary data that is also available such as a fund's annual audited financial statements and Markets in Financial Instruments Directive ("MiFID") pre & post-trade transparency requirements. Therefore, the focus should be on first enforcing existing practices before new policies are introduced. IF would also strongly advocate against disclosure of actual positions at other prime brokers as this is commercially sensitive.

Irish Funds therefore contend that in many markets sufficient data is already available and that, in cases such as Archegos, the risk exposures from leverage are best managed by those providers of leverage.

Finally, IF would be cautioning against any recommendations that would restrict the number of prime brokers a fund manager can engage. Being able to access different prime brokers across jurisdictions enables managers to both leverage local expertise and diversify their risk exposures.

16. What are the main impediments that leverage users face in sharing additional or more granular data with their leverage providers? Is there a risk that a minimum recommended set of disclosures may lead leverage users to limit the information they share with their leverage providers to that minimum set?

IF welcomes the FSB's recognition that disclosures should be proportionate, risk-based and "*allowing for proprietary client information to remain confidential*". Ultimately, there has to be a balance struck between the benefits of more granular data being reported to leverage providers and the risk of disclosing commercially sensitive information. Only disclosures that are strictly necessary to manage leverage risk should be provided. Please also see the IF response to question 15.

17. Should such a minimum set of disclosures rely on harmonised data and metrics to ensure transparency and efficiency in the use of such information for risk management purposes? Do respondents agree that such a minimum set of disclosures should be based on the list of principles outlined in the consultation report? If not, which principles should be added, deleted or amended?

IF does not agree that disclosures should be based on the list of principles within the consultation report. We note the principles include that "*Clients should provide aggregate information on their exposures across all entities or vehicles that are managed under a common strategy or decision-making process, to capture the impact of a coordinated liquidation across the client's full range of related investment products or vehicles*". IF believe that requiring disclosure of positions at other prime brokers is essentially requiring the release of commercially sensitive information. This would represent a fundamental shift in market mechanics and could greatly curtail the number of prime brokers that NBFIs trade with, which would be a significant negative development as diversification of prime brokers is optimal for risk diversification.

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

IF would contend that this is standard industry practice and that leverage providers already determine the information that they require from leverage users at the point of granting the leverage exposure/facility and on an ongoing basis. This information should be consistently required to aid with risk management within the leverage providers. Regular engagement between prime brokers and their counterparties also already exists and therefore they should be able to identify those counterparties that are facing liquidity challenges. As a result, IF would not see a need for a blanket mandate requiring enhanced reporting (in the case of a stress event) for all participants. Instead, we would advocate that the information being received, together with regular engagement, should be sufficient to flag potential issues. This approach would allow for a more efficient and targeted resolution of any issues. Indeed, mandating additional reporting for all firms to their leverage providers in times of stress is likely to lead to an information overload for prime brokers, diversion of firm resources that should be spent mitigating the risk and distracting from the management of those accounts that are actually at risk.

19. Should authorities design a minimum set of harmonised disclosures and guidelines on its application, or should they convene a cross-industry working group to do so? How do respondents believe such a standard should be incorporated into market practice? Through regulation, supervisory guidance, and/or via a Code of Conduct or similar approach?

No Response.

Recommendation 8: Authorities should adopt the principle of "same risk, same regulatory treatment" and identify incongruences in the regulatory treatment of NBFI leverage resulting from similar exposures, financial instruments or structures that may distort incentives and result in regulatory arbitrage. Where incongruences are identified, authorities, in cooperation with SSBs, should analyse the underlying causes to determine whether and how to address the identified incongruences, having regard to the treatment of similar situations in other jurisdictions, so that domestic remediation efforts do not create new disparities that could transfer risk across borders.

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

Due to the diverse nature of the financial ecosystem, the principle of 'same risk, same regulatory treatment' would be difficult to implement, and does not appear to appreciate either the diversity of the term 'risk' or the robust regulatory environment that funds already operate in.

Even within the funds sector risks will vary i.e. if multiple funds hold the same security, they are subject to the same investment risk but not subject to the same entity/product risk. For example, the level of equity or the redemption rights offered to investors will vary by fund and therefore the risk impact will be different. EU regulated funds are already governed by the well-tested and robust AIFMD/UCITS frameworks, with both having been reviewed and updated, with significant work ongoing around liquidity management, and enhanced reporting as a result. Therefore, IF would have concerns that this principle may lead to an unnecessary and/or unsuitable overlay of regulation. Equally, from an entity perspective the 'agency' model that governs funds means that the losses/shocks to an individual fund/investment will have a different impact than it would for other financial market participants.

In terms of leverage specifically, both UCITS and AIFs are currently subject to certain leverage restrictions, risk management requirements and/or scrutiny through both vehicle specific and diversification limits (in the case of UCITS), supervisory reporting (e.g. there is enhanced reporting requirements for AIFs where leverage >300%), public disclosures, along with supervision and enforcement powers held by the relevant authorities. As acknowledged in this consultation, leverage in funds is typically low and therefore IF would be reluctant for further overlays to be introduced for funds to solve perceived weaknesses in other areas of the financial system. So, while we welcome the recognition that "Congruent treatment should not imply identical treatment", and "authorities should have regard to the specific characteristics of different entities" (along with their regulatory requirements), concerns remain that by applying further regulatory restrictions on funds could have unintended consequences.

Furthermore, IF does not believe that movement of positions from central clearing to bilateral markets (for products not subject to mandatory clearing) breaches the principle of 'same risk, same regulatory treatment'. We would contend that non-centrally cleared trades executed in bilateral markets are subject to a robust regulatory framework (prescriptive margin and regulatory reporting), and the flexibility with regards to collateral posting under their credit support agreements can act as a risk mitigant, preventing procyclical deleveraging during periods of liquidity stress.

Ultimately, IF is supportive of greater regulatory collaboration and information sharing between regulators and authorities to ensure that any potential risk is scrutinised carefully before additional measures are introduced but would not be supportive of bank-like macroprudential measures being applied to funds.