February 28, 2025

Submitted via the FSB secure online form and email to: fsb@fsb.org

Re: Financial Stability Board Consultation Report, December 18, 2024 "Leverage in Non-bank Financial Intermediation"

The Asset Management Group of the Securities Industry and Financial Markets Association ("**SIFMA AMG**")[1] appreciates the opportunity to respond to the questions raised in the Financial Stability Board's Consultation Report on Leverage in Non-bank Financial Intermediation (the "**Consultation Report**").[2] Our members are composed of market participants across the asset management industry, many of which fit within the Consultation Report's broad category of non-bank financial intermediaries ("**NBFIs**").

The diversity of unique business models and funding strategies across various sub-categories of NBFIs underscores the challenge in applying prescriptive, "one-size-fits-all" standards and highlights the need for a more targeted, data-driven approach to evaluating any financial stability risks that may be posed by NBFIs' use of leverage. Within the asset management industry in particular, managed funds, hedge funds, private equity funds and other investment funds all differ in the amount of leverage they rely on, the means through which they source it, the purposes for which they deploy it and the risk management practices that accompany their use of leverage. Further, the implementation of regulatory reforms around the globe over the past decade and a half, particularly in the derivatives markets, has significantly mitigated risks with respect to so-called 'synthetic' leverage.

It also cannot be understated that the use of leverage is not unique to NBFIs, as leverage is heavily relied upon by both prudentially regulated entities such as banks and non-financial institutions, including corporates and sovereigns of all types. Broadly speaking, we urge the Financial Stability Board ("**FSB**") to identify with more precision and supporting evidence the potential financial stability concerns posed by the use of leverage by NBFIs and why such concerns are not sufficiently addressed by the current regulatory framework. In particular, we believe that any risks posed by the use of leverage within the asset management industry have largely been addressed through targeted regulatory reforms. For example, under the Securities and Exchange Commission's ("**SEC**") Rule 18f-4, certain mutual funds, exchange-traded funds, closed-end

[1] SIFMA AMG brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.
[2] Financial Stability Board, *Leverage in Non-bank Financial Intermediation* (December 18, 2024), available at https://www.fsb.org/uploads/P181224.pdf.

funds and business development companies are subject to limits on their derivatives transactions based on value-at-risk ("**VaR**") limits, and managers are required to implement governance and board oversight over the use of such funds' derivatives positions. In addition, the expansion of central clearing in the OTC derivatives market coupled with new margin frameworks for uncleared OTC derivatives adopted over the past decade and a half has improved collateralization practices across the market and acts as an effective risk-based limit on leverage. Finally, as we describe further below, applying prudential and other regulatory requirements that have traditionally applied only to the banking industry to asset managers is not appropriate and may have the opposite intended effect on financial stability risks.

Overview

The Financial Stability Board's report on the Financial Stability Implications of Leverage in Non-Bank Financial Intermediation (the "**2023 Report**")[3] finds that within the broader umbrella of NBFIs, insurance companies, pension funds and investment funds account for most of the assets held by NBFIs but comprise less than a tenth of total NBFI sector debt. Considering the breadth of NBFIs and the variance in their usage of leverage, imposing the same prescriptive measures on *all* NBFIs such as minimum haircuts, limits on leverage and stress testing requirements is not only impractical and unnecessary but will inevitably penalize certain market participants over others.

For example, within the NBFI sub-category of hedge funds, the 2023 Report cites hedge funds pursuing macro and relative value strategies as relying on high levels of synthetic leverage through derivative positions relative to hedge funds focusing on other strategies, such as credit or event-driven strategies.[4] However, such measures provide a distorted and significantly overstated view of leverage by relying on a 'gross notional exposure' metric which does not represent underlying risk factors. Simply put, the actual risks associated with a given notional amount of a USD interest rate swap and an equivalent notional amount of a high yield credit default swap are vastly different. Further, hedge fund portfolios often include offsetting positions that reduce risk as opposed to amplifying it. Thus, high amounts of gross notional exposure can actually reflect low levels of actual net exposure. Additionally, hedge funds that use a long/short equity strategy will have vastly different levels of leverage than, for example, a relative value fixed income strategy. Finally, many simplistic measures of leverage do not take into account the degree to which portfolios are collateralized, subject to margin and netting arrangements and otherwise prudently risk managed.

The Bank of England's recent System Wide Exploratory Scenario ("**SWES**") exercise provides a model for a holistic, data-driven and collaborative effort between public and private participants to better understand (i) the different ways that various NBFI sectors react to market shocks, (ii) any financial stability risks that may be posed by banks and NBFIs in stressed market conditions, and (iii) potential measures to address such risks.[5] For example, the final report highlighted that "[r]epo market resilience is central to supporting core markets in stress," and thus that "[f]urther policy work to increase repo market resilience, could, alongside central bank

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[3] Financial Stability Board, *The Financial Stability Implications of Leverage in Non-Bank Financial Intermediation* (September 6, 2023), available at https://www.fsb.org/uploads/P060923-2.pdf.
[4] 2023 Report, at 20.
[5] Bank of England, *System-Wide Exploratory Scenario Exercise Final Report* (November 29, 2024), available at https://www.bankofengland.co.uk/financial-stability/boe-system-wide-exploratory-scenario-exercise/boe-swes-exercise-final-report (the "**SWES Report**").

facilities, help support repo market resilience and the effective functioning of other markets during stress."[6] The SWES Report also helpfully noted the risk management practices employed by various NBFI segments. For example, the final report observed that participating hedge funds experienced only a modest loss in their net asset value (NAV) despite the severe shock, with a number of factors contributing to their resilience, including "high levels of unencumbered cash to meet potential IM/VM calls" and "less frequent redemption terms/conditions (e.g., quarterly)."[7]

The Consultation Report and 2023 Report also seem to disregard the many benefits of leverage. Derivatives and structured finance trades, for example, facilitate the efficient transfer of risk, promote price discovery, can stabilize markets, and provide financing to assets. Additionally, access to leverage can provide important countercyclical effects; for example, access to deep and liquid markets can facilitate an NBFI's overall liquidity preparedness in stress, which can reduce the likelihood of a sudden deleveraging cycle and destabilizing asset sales as well as the propagation of stress to other parties. Both the Consultation and 2023 Report appear to impugn the use of leverage without proper consideration of the important role it plays in the smooth and efficient functioning of markets.

Both the 2023 Report and the Consultation Report also do not sufficiently account for the many market and regulatory reforms that have been implemented since the 2008 financial crisis, which not only provide greater transparency to regulators but also significantly mitigate any financial stability risks that may be posed by NBFI leverage. We urge the FSB to recognize that NBFIs are already subject to comprehensive regulatory frameworks within their respective jurisdictions and generally transact in markets that are similarly highly regulated. The FSB should refrain from recommending incremental or overly prescriptive requirements without consideration of recent market-wide regulatory reforms.

Following the G20 reforms, for example, derivatives (i.e., swaps) are now subject to a robust regulatory framework that includes, among others, robust mandatory margin requirements and central clearing mandates for a wide variety of standardized rate and credit derivatives, which significantly reduce risks from the counterparty channel by diminishing the likelihood that any losses faced by an NBFI is propagated to its counterparties or providers of leverage. In a similar vein, as recently as December 2023, the U.S. Securities and Exchange Commission adopted a final rule to expand central clearing for both cash and repo transactions in the U.S. Treasury markets.

Additionally, the adoption of more robust risk-based capital charges for derivatives exposures of banks (otherwise known as SA-CCR) as well as the recommendations of the BCBS Guidelines for Counterparty Credit Risk Management[8] (the "**BCBS Guidelines**") for sound counterparty credit risk management afford bank regulators and supervisors a more targeted approach to reducing concentrations and countering the transmission risks posed by NBFI leverage.

The Consultation Report should also include more thoughtful consideration of the potential drawbacks and unintended consequences of deploying its very own recommendations. In addition

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[6] SWES Report, Conclusions.

[7] SWES Report, Annex 4: Sector-specific deep dives (Hedge funds).

[8] Basel Committee on Banking Supervision, *Guidelines for counterparty credit risk management* (April 30, 2024), available at https://www.bis.org/bcbs/publ/d574.pdf.

to the burdensome costs of any additional reporting and disclosure requirements, we remain highly concerned that the introduction of any entity-based measures such as caps on leverage, minimum haircuts and increased margin requirements could have the net effect of reducing market liquidity and increasing the cost of hedging, among others.

Responses to Questions

Recommendation 1

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

The Consultation Report and the 2023 Report provide a high-level theoretical description of the transmission channels by which excessively leveraged NBFIs may amplify and 'spread' risk to other financial institutions, including banks and non-banks – specifically (i) the position liquidation channel (i.e., the risk that liquidity needs lead to fire sales, creating asset price volatility) and (ii) the counterparty channel (i.e., the risk of NBFI default or distress spreading to other counterparties).

In our view, however, an overly simplistic linkage between the mere existence of NBFI leverage and purported financial stability risks (i) fails to recognize the various market reforms that have been introduced and adopted since the 2008 financial crisis, (ii) understates the degree to which leverage improves the proper functioning of markets and provides a countercyclical impact during periods of stress and (iii) creates the misimpression that a mere reduction in NBFI leverage through limits on leverage, concentration add-ons and other entity-based measures will mitigate, rather than amplify, systemic risk.

Firstly, many market reforms (including several of the activity-based measures highlighted as recommendations in the Consultation Report) have already been adopted since the 2008 crisis, significantly mitigating any purported financial stability risks posed by NBFI leverage. In the United States, for example, the SEC and Commodity Futures Trading Commission ("**CFTC**") have finalized requirements to collect and post margin for uncleared swaps. We note, in particular, that the Archegos failure, which is cited in the Consultation Report as a stress event directly caused by the excessive build-up in leverage through one NBFI in particular, is significantly less likely to occur today given the SEC's uncleared margin requirements and implementation of reporting and recordkeeping requirements for security-based swaps.

Cleared derivatives, both futures and swaps, have long had a robust margin regime for all market participants. The CFTC, acting under authority provided by the 2010 Dodd-Frank Act, introduced mandatory central clearing for standardized derivatives through registered central clearinghouses to enhance transparency and reduce systemic risk. Over time, the scope of central clearing mandates has expanded to include the vast majority of interest rate swaps, including fixed-to-floating swaps and basis swaps and credit default swaps against major credit indices such as CDX and iTraxx.[9] The SEC has also recently adopted a final rule requiring most market

[9] *See*, generally, 17 C.F.R. Part 50.

participants to report and centrally clear cash and repo transactions on U.S. treasuries.[10] Similar reforms have been adopted in the U.K., E.U. and elsewhere in accordance with commitments made by the G20 leaders in a 2009 summit, which emphasized the importance of clearing through central counterparties to improve the proper functioning of derivatives markets.[11] Lastly, the adoption of more robust reporting standards and the increased resiliency of providers of leverage such as banks through enhanced capital and other requirements for counterparty credit risk have all had the collective effect of reducing the likelihood of contagion following the default or distress of any one NBFI.

Secondly, NBFI leverage can be a critical lever to mitigate financial stability risks. Leverage supports key functions such as hedging, funding, and resolution of market imbalances through arbitrage opportunities. Additionally, the use of leverage by countercyclical investors can actually restore liquidity and provide stability to markets undergoing stress; for example, hedge funds and other proprietary trading firms can step in to buy assets at distressed prices, thereby mitigating extreme price swings.

Lastly, the size or notional amount of NBFI leverage in and of itself is a poor proxy for measuring any purported financial stability risks. As noted above, some hedge funds and other types of leveraged investors may exhibit high levels of gross notional exposure but low levels of actual net risk due to the offsetting nature of their positions. Additionally, some pension funds may rely on FX derivatives to hedge their FX exposures to investment strategies that include securities that are settled in foreign currencies. This use of derivatives may present as leverage but is actually employed to reduce the FX risk to the pension fund. Moreover, the fund may very well enter into deliverable FX forwards, which protect the fund against market risk but, because of their nature, do not require margining.

We urge the FSB to spend more time considering how risks related to NBFIs' use of leverage may actually be specifically propagated through the two transmission channels in question as opposed to reflexively imposing prescriptive measures and minimum requirements, which could ultimately create new pockets of systemic risk.

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?**

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?

[10] Standard for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker Dealer Customer Protection Rule With Respect to U.S. Treasury Securities, Release No. 34-99149 (December 13, 2023), available at https://www.sec.gov/files/rules/final/2023/34-99149.pdf

[11] G20 Leaders Statement: The Pittsburgh Summit (Sep. 24-25, 2009), available at https://ec.europa.eu/archives/commission_2010-2014/president/pdf/statement_20090826_en_2.pdf.

(iii) concentration and crowded trading strategies?

In our view, none of the metrics listed in Annex 1 of the Consultation Report provide a useful or accurate picture of the purported financial stability risks posed by NBFI leverage. For example, the use of gross financial leverage and gross synthetic leverage metrics may create the misimpression that certain NBFIs, including hedge funds or other investment funds with high amounts of synthetic leverage, may be riskier than those that do not. Instead, hedge funds, private credit funds and other investment funds may enter into derivatives transactions to hedge specific risks such as interest rate or foreign exchange risk as opposed to making speculative directional bets on the market. Such metrics can therefore grossly over or understate the level of underlying risk.

Adjusted leverage metrics are also impractical as it would be impossible for regulators to select the precise adjustments that properly account for the risks posed by the underlying leverage. Such an exercise will inevitably produce "winners" and "losers", frustrating the goal of "same risk, same regulatory treatment," and supplant the judgment of market participants for those of regulators. We note that sell-side market participants, particularly larger dealers, in many instances impose financial requirements on counterparties in the form of minimum equity, maximum leverage, and other requirements, on top of conducting diligence and monitoring their counterparties' overall use of leverage.

As we have noted in our letters to the Financial Stability Oversight Council[12], imposing bank-style macro-prudential requirements on asset management firms or investment funds, including setting supervisory requirements around liquidity metrics like the roll-over risk ratio and stress testing metrics, is not appropriate in the context of traditional asset management and investment activities, which do not pose the same threat to financial stability as banks do. We note, also, that a number of similar regulatory measures are already in place tailored for the asset management industry and investment funds – for example, the SEC's rules require mutual funds to implement liquidity risk management programs.[13] Additionally, as noted in our discussion above regarding the SEC's Rule 18f-4, investment companies and business development companies are already subject to limits on synthetic leverage, including limitations on their use of derivatives and other transactions.

Importantly, it is our view that key data about leverage, including synthetic leverage via derivatives, is already available to regulators in all major jurisdictions due to mandated reporting requirements, including the reporting of derivatives positions through trade repositories. In addition, in the U.S., private fund advisers are required to make filings under Form PF that provide copious amounts of data with respect to the underlying investment funds they manage. The SEC also requires private funds to submit quarterly reports which include statistics on asset and liability terms and extensive scenario stress tests to show the impact of market moves on their portfolios. Such forms provide detailed information about the use financing by investment funds, their total

[12] SIFMA, Letter to Financial Stability Oversight Council, *Re: Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies* (May 13, 2019), available at https://www.sifma.org/wp-content/uploads/2019/05/Active_75778944_1_SIFMA-AMG-LETTER-TO-FSOC-MAY-13-2019-FINAL-PDF.pdf.
[13] Investment Company Liquidity Risk Management Programs, 17 CFR Parts 210, 270, 274, Release Nos. 33-10233; IC- 32315; File No. S7-16-15, RIN 3235-AL61 (Oct. 13, 2016), available at: https://www.sec.gov/rules/final/2016/33-10233.pdf.

amount of borrowings and types of creditors, their outstanding derivatives positions, their strategy, the balance of their derivatives that are executed on exchanges and/or cleared with central counterparties, their total exposures, etc. Additionally, trade repositories collect information ranging from counterparty information, notional amounts, valuations, and risk metrics. As recently as May of 2024, the U.S. federal banking agencies finalized new reporting requirements for all insured U.S. banks with more than $10 billion in net assets to include credit exposures to "non-depository financial institutions" in their quarterly call reports.[14]

Consequently, local regulators already have access to available data to track exposures of counterparties as well as to monitor markets for any excessive build-up in leverage. Rather than imposing new data collection requirements that introduce ever greater compliance burdens, regulators should seek to use existing data more effectively for the system-wide reporting they seek.

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?**

SIFMA AMG does not object in principle to the disclosure of certain aggregate and anonymized data provided it is done on a sufficiently delayed basis, and not done with a level of frequency or sufficient granularity that allows others to "reverse engineer" sensitive portfolio and transaction data. We note, for example, that the Commitments of Traders weekly report published by the CFTC provides a key data source to traders and other market participants.

However, we remain concerned that poorly designed or calibrated public disclosure frameworks can have unintended consequences, including amplifying volatility and creating the risk that data will be misleading or misinterpreted by the market, leading to herd behavior and further financial stability risks. To this day, for example, banking organizations in the U.S. remain reluctant to borrow from the Federal Reserve's discount window, even when such borrowings may be commercially in their best interests to resolve short-term liquidity needs, as the market will inevitably interpret any discount window advances as indicative of stress and potential failure, thereby triggering a bank run.

Additionally, public reporting of trade positions may result in herding and copy-cat behavior, thereby resulting in further concentration risks. In the United States, for example, investment managers are required to make quarterly Form 13F filings to the SEC disclosing their holdings. Investors may be inclined to replicate market positions taken by large, reputable hedge funds and asset managers without performing sufficient thorough independent analysis, while other investors may be deploying quantitative strategies that allocate capital based on trends in

[14] Department of the Treasury, Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation, *Agency Information Collection Activities; Submission for OMB Review; Comment Request*, 89 F.R. 45046 (May 22, 2024), available at https://www.govinfo.gov/content/pkg/FR-2024-05-22/pdf/2024-11221.pdf.

Form 13F filings, significantly increasing concentration risks. We urge that any public disclosure proposals should be accompanied by a robust analysis to determine whether the benefits of such additional disclosures outweigh any potential negative consequences.

In particular, we advise against any public position disclosure proposals that would compel investment funds to directly or indirectly publicly reveal their otherwise confidential investment positions and trading strategies in unprecedented detail and within relatively short time horizons. Academic research has shown that the public disclosure of otherwise confidential investment positions – even on a limited basis and with long reporting timeframes – impairs investment returns and negatively impacts market quality and efficiency. The potential consequences of such disclosures include:

- Facilitating copycatting and free-riding;
- Allowing other market participants to reverse engineer investment theses and trading strategies;
- Compromising investors' ability to establish and risk manage right-sized positions without having outsized market impact; and
- Reducing incentives to conduct fundamentally driven research

This in turn negatively impacts market quality and efficiency by impairing the price discovery process, diminishing market efficiency and liquidity, and undermining the critical role that actively managed investment strategies play.

We also contend that the existing framework of private disclosures to counterparties and providers of leverage as part of an effective due diligence exercise is a preferable option for addressing the concerns raised by excessive NBFI leverage. Additionally, disclosures to regulators such as through trade repositories can provide regulators with the data they need to react quickly to excessive concentrations of risk – for example, the Archegos Capital collapse would be more challenging to replicate (or regulators can act more swiftly) now that data on security-based swaps is available via swap data repositories.

We are also concerned that any additional public reporting requirements will introduce new compliance burdens without a concomitant benefit, and may result in a significant reduction in market participation and liquidity to the extent data is made available on a real-time, non-anonymous basis. For example, a hedge fund may be reluctant to invest in a particular asset using leverage out of concern that public disclosure of that position will cause malicious actors to attempt to "squeeze" the fund by manipulating prices.

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?**

At a high level, SIFMA AMG is concerned that the incorporation of policy-based, prudential-style limits on leverage through the imposition of entity-based measures are not sufficiently informed by meaningful and targeted data or economic analysis. For example, the 2023 Report acknowledges the need for additional monitoring and data to properly assess the risks of NBFI leverage, particularly within various subcategories of NBFIs, yet moves reflexively towards direct or indirect limits on leverage without proper consideration of whether such constraints are justified, nor the unintended consequences posed by such constraints.

As noted above, various regulatory enhancements have been adopted since the implementation of the Dodd-Frank Act, resulting in significant improvements in the U.S. These changes demonstrate that the primary regulator of the asset management industry – the SEC – has a highly flexible regulatory toolkit, which includes, among other things: rulemaking, exemptive and interpretive authority; inspection and examination authority; and the ability to collect and analyze industry and firm-specific data and information. These regulatory tools enable the SEC and its staff to craft regulatory responses that are carefully tailored to address the specific nature and characteristics of a given risk or area of regulatory concern. SIFMA AMG supports the imposition of certain activity-based measures that leverage the expertise, skills, and experience of individual financial regulators. Indeed, in practice, the SEC has demonstrated that it is more than up to the task of effectively monitoring and appropriately responding to perceived risks and threats in the industry. The SEC and its staff have remained on the forefront of proactively and effectively monitoring trends, dynamics, changes, and risks in the asset management industry.

The fundamental characteristics of the asset management industry—particularly as compared to the banking industry and other types of financial institutions—are worth highlighting. Asset managers are quite different from banks and other types of financial institutions, namely in that they act on behalf of their clients rather than themselves. The imposition of macro-prudential banking-style regulation on asset management firms would be inappropriate and would have significant consequences for the economy. For example, it is easy to envision a scenario where the application of entity-based measures such as limits on leverage will severely damage that firm's competitive posture: the compliance burdens, imposition of new regulatory requirements and the corresponding costs and uncertainties, for instance, could cause clients to move towards other competitors not subject to such requirements. But on the other hand, one could also envision a scenario where the application of entity-based requirements would ironically serve as a potential competitive advantage for the firm and enable it to attract more clients.

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?

Echoing concerns raised by banking and markets regulators in the United States, the European Union, Japan and the United Kingdom, SIFMA AMG remains concerned that minimum haircut floors for securities financing transactions ("**SFTs**") will result in significantly higher transaction costs for market participants, leading to lower trading volumes and market liquidity. Ironically, by reducing liquidity in markets, especially in government bond repo markets, minimum haircuts may have the net effect of exacerbating financial stability risks as market participants are either forced to unwind positions or source additional collateral. Additionally, it would be misleading to assume that the lack of minimum haircuts imposed by regulation means that no haircuts currently exist in the market today. For example, minimum haircuts in the sovereign bond repo market are common as repo sellers may require some haircut to manage the volatility of the underlying collateral. Additionally, the Consultation Report suggests that non-centrally cleared, bilateral repo markets are not currently subject to minimum haircuts today. However, this does not account for the fact that many repo transactions are part of a broader portfolio subject to a master netting agreement, and as such, counterparties are in fact appropriately collateralizing the risk of their portfolio through other margin payments.

Similarly, banking regulators around the world have explored imposing minimum haircuts on securities financing transactions, but none have yet come to fruition. The European Banking Authority (**"EBA**"), for example, concluded in a policy report that the European Union should withhold the implementation of minimum haircuts for SFTs on the basis that doing so could lead to "unintended behaviourial consequences", including reduced liquidity and higher costs for clients.[15] Additionally, the initial proposal by the U.S. banking agencies to implement the Basel III finalization package (colloquially known as "Basel Endgame") initially introduced a minimum haircut for SFTs, but the Federal Reserve's then-vice chair of supervision, Michael Barr, subsequently confirmed that such a minimum haircut would be eliminated on the basis that no other jurisdiction had done the same.[16]

As it relates to enhanced margin requirements and central clearing mandates, SIFMA AMG acknowledges that central clearing and margin requirements can reduce counterparty risks and improve market resiliency. However, we wish to emphasize that many jurisdictions around the world have largely adopted the BCBS-IOSCO's requirements for margin requirements and central clearing. For example, the CFTC has implemented statutory central clearing mandates for a large swath of financial instruments, including interest rate swaps and index credit default swaps. The CFTC, SEC and federal banking agencies have also implemented initial and variation margin requirements for various categories of entities including swap dealers, major swap participants, security-based swap dealers and major security-based swap participants. Furthermore, the list of

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[15] EBA, *Policy Advice on the Basel III Reforms on Securities Financing Transactions (SFTs)* (August 2, 2019), at 4.
[16] Michael Barr, *The Next Steps on Capital* (September 10, 2024), available at https://www.federalreserve.gov/newsevents/speech/barr20240910a.htm.

available exemptions (e.g., end-user exemption) and products deemed to be out-of-scope (e.g., non-standard equity derivatives) for mandatory clearing reflect a proper balancing of costs and benefits to ensure such mandates are sufficiently workable and do not create certain unintended adverse consequences, such as increasing the costs of hedging for non-financial commercial counterparties. We caution against imposing prescriptive, one-size-fits-all requirements that go above and beyond the regulatory reforms implemented across the relevant jurisdictions without careful consideration of any attendant drawbacks.

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?**

While minimum margin and haircut requirements are questionable in light of the reasons discussed in this letter, we urge the FSB to refrain from recommending or adopting dynamic add-ons, which may spur deleveraging cycles as market participants are forced to sell assets to meet margin calls precisely at a time when markets may already be stressed. We are also concerned that dynamic approaches to minimum and haircut requirements will be overly broad and not properly capture the risks posed by specific NBFIs – we can easily envision a scenario where investment funds with offsetting derivatives positions may be forced to unwind positions due to their inability to meet margin calls, which could lead to losses and further transmit stress to counterparties, despite the low risk of their total leverage exposures.

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

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?**

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?**

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

Within the context of the asset management industry, for SEC-registered investment funds and with respect to certain products they may trade, there already exist clear limits on leverage. We feel strongly that additional minimum direct or indirect leverage limits will be unworkable in practice as the industry is simply too diverse with respect to entity type, business type, and business volume.

For example, imposing entity-based limits on leverage in the form of balance sheet ratios would be impractical given the wide variety of NBFI business models and the varying degrees to which they rely on leverage. A one-size-fits-all approach will place significant constraints on certain NBFI business models such as hedge funds which rely on relative value strategies, potentially rendering them economically untenable and could thereby result in lower market liquidity and trading volumes overall. Such effects could serve to inhibit price discovery and increase transaction costs for all market participants. Furthermore, limits on leverage may constrain the ability of market participants to hedge risks and provide liquidity to broader markets, thereby exacerbating financial stability risks. Additional targeted, firm-specific, or category-specific limits on leverage may also create regulatory arbitrage opportunities as market participants may simply relocate or restructure their operations to avoid such limits or take advantage of lower ones, which may exacerbate risk by leading to large concentrations of exposures in specific types of NBFIs.

Finally, any risks posed by NBFI leverage will vary considerably depending on how such leverage is applied; some NBFIs may rely on leverage to take directional positions while others may use it to hedge risks. Any entity-based limits on leverage will therefore be inevitably too low for most NBFIs; no cap will be sufficiently granular enough to properly account for the risks posed by any one individual NBFI.

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?**

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?**

We support the BCBS Guidelines, which encourage banks and supervisors to take a risk-based and proportional approach to applying the guidelines for sound counterparty credit risk management. Among other recommendations, the BCBS Guidelines encourage banks to conduct through counterparty credit due diligence, engage in ongoing credit monitoring and deploy sound closeout practices, among many others. In particular, we would discourage the FSB from imposing minimum standards or requirements that may serve as “check-the-box” exercises for banks when onboarding counterparties or leverage users without a careful examination of their underlying risk profiles.

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?**

SIFMA AMG acknowledges that depending on the counterparty type, the business type, and the volume of business, prudent risk management may require an understanding of leverage levels to assess risk and set exposure limits. The requirement for disclosures is already well-embedded into trading relationships and leverage providers do not extend business to leverage users that are not appropriately transparent in this area.

That being said, there are at least two significant challenges to establishing a minimum set of disclosures. First, given the diversity of counterparty types, business types, and business volumes, a one-size-fits-all approach would be less valuable in some circumstances and over-kill in most other circumstances. Leverage providers should instead be encouraged to tailor their requirements to the specificities of each relationship as part of their prudent risk management. Second, regulators must be cognizant of the sensitivity of such proprietary leverage information and the risk of abuse of portfolio deconstruction and front-running that could arise from the provision of any standardized minimum set of disclosures.

An appropriate level of such information should only be required and shared with respect to appropriate business relationships and therefore should not be adopted via blanket requirements.

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?**

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?**

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?**

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?**

SIFMA AMG disagrees that additional granular data provided by users of leverage, including through harmonized data and metrics, will either mitigate the purported financial stability risks presented in the 2023 Report or even be useful to market participants, including trading counterparties and providers of leverage. By way of example, the disclosure obligations for registered funds in the United States or UCITS in the E.U. are already quite plentiful and onerous. Regulators and legislators should not impose their judgment in such a way as to override that of market participants, as that will lead to market inefficiencies and unnecessary costs.

Requiring additional disclosures, particularly those in a standardized format or via flat leverage or concentration metrics, will not only necessitate costly adjustments to operational procedures and reporting systems, but also inundate market participants with additional amounts of highly standardized information that will obfuscate the underlying risks and impede, rather than facilitate, a thorough due diligence exercise.

Should the FSB deem it necessary to craft minimum disclosures around NBFI leverage, we urge such disclosure requirements to be principles-based as opposed to prescribing the specific information that leverage providers must receive, as regulators cannot possibly legislate for every field of information that a leverage provider may need.

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?**

Our view is that the application of bank-like macroprudential tools (e.g., capital requirements) to the asset management industry would result in either a cash drag or negative performance or both, and could be redundant of or conflict with existing, more tailored rules.

In the U.S., for example, the SEC has imposed liquidity risk management requirements as well as restrictions on the use of derivatives. Regulators in other jurisdictions, such as the Hong Kong Monetary Authority, have also imposed liquidity risk management requirements for funds incorporated or marketed in their jurisdictions.

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On behalf of SIFMA AMG, we appreciate the opportunity to respond to the Proposed Rules and your consideration of our comments and recommendations. If you have any questions or require additional information, please do not hesitate to contact us by calling William Thum at (202) 962-7381.

Sincerely,

William C. Thum
Managing Director and Associate General Counsel, SIFMA AMG