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COMPETITIVENESS

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Dr. Shane Worner
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Submitted via email to consultation-08-2018@iosco.org

RE: Public Comment on IOSCO Report: Leverage

Dear Dr. Worner,

The U.S. Chamber of Commerce, Center for Capital Markets Competitiveness ("CCMC") appreciates the opportunity to comment on the International Organization of Securities Commissions' ("IOSCO") consultation paper on leverage. We are supportive of global guidelines around leverage in order to establish a consistent basis for regulatory frameworks around the world and appreciate IOSCO members' engagement on this consultation. We also appreciate IOSCO encouraging different jurisdictions to determine the most appropriate risk assessment to adopt and agree that "there is no single measure that can capture the leverage exposure of all types of funds."

The proposed Step 1 metrics appear to reflect industry input around regulators needing to adjust gross national exposure for duration and other risks as well as the fact that hedges and offsetting positions do not create leverage. However, we are concerned that the metrics in the consultation are all largely based on notional exposure, which is not an accurate representation of actual mark risk exposure.

While Step 1 largely looks at various measures of exposure there is relatively little discussion or guidance on how IOSCO member regulators will use these metrics to assess risks and vulnerabilities. We call for a clear statement that moving a fund to Step 2 analysis is not a presumption that the fund presents systemic risk and it would not lead to designation or additional regulation. Rather, this will be a process by which regulators will discuss with managers the types of leverage-related risks their fund is exposed to and how these risks are being managed and mitigated.

Metrics based on notional exposure do not provide an accurate measurement of risk.

For the first step in the proposed two-step process, IOSCO proposes metrics to measure exposure and to narrow down for further evaluation the universe of funds that may pose a risk to financial stability. IOSCO proposes three metrics to measure exposure within investment funds: 1) Gross Notional Exposure (GNE) without adjustment; 2) Adjusted Gross Notional Exposure; and 3) Net Notional Exposure (NNE). Of the three proposed metrics, CCMC is most supportive of the NNE metric, since it takes into account the extent to which a fund's investments may be netted as well as hedging, but we encourage IOSCO to further explore incorporating risk-sensitive components. Funds use derivatives to hedge their own risk in a number of different ways, ranging from liquidity risk to currency risk, which helps preserve the economic return sought by investors. These hedging transactions do not pose financial stability risks, therefore they should be excluded from any measurement of exposure or leverage. Additionally, different derivatives often offset risk to one another, but a test based solely on gross notional exposure would not recognize the risk-neutrality of netted positions.

As noted by IOSCO in the consultation, each of the proposed metrics is based on notional exposure, which does not provide an accurate measurement of "market exposure" for the purpose of calculating leverage-related risks. The metrics may indicate which funds use leverage (or may just indicate which funds are large), but they will not present an accurate risk profile of a fund. IOSCO acknowledges these shortcomings and therefore proposes using the metrics by asset class, rather than in a single, aggregate figure. CCMC supports this approach and agrees that this will allow regulators to compare exposures across funds more meaningfully. After presenting the metrics and the explanation of analysis by asset class, IOSCO states, "We consult on GNE, Adjusted GNE, and NNE broken down by asset classes rather than solely presented as one aggregated number. Any further references to GNE, Adjusted GNE or NNE in this consultation paper should be understood as broken down by asset classes." To clarify that this is IOSCO's preferred approach, we would encourage making this statement at the outset of any final principles. Using only the metrics identified, based on notional exposure, would not identify products that are inherently risky. For example, the risk profile of an interest rate swap can differ dramatically from the risk profile of a credit default swap, even if they both have the same notional value. Simply using notional exposure as a metric would present an outsized depiction of risk; therefore we support asset class analysis.

CCMC also supports regulators evaluating additional, supplementary data points related to portfolio composition, particularly risk-based measures, to analyze a fund's leverage-related risks as part of the Step 2 risk assessment. However, the application of particular data points will depend on the portfolio; therefore local jurisdictions must have the flexibility to define which supplementary data points should be considered. Even with the analysis of metrics by asset class and supplementary data points, further analysis by the securities regulator and engagement with the fund manager is necessary to fully understand the risk profile of a fund.

<u>The goals and use of data in "Step 2" should be cleared defined.</u>

We appreciate the goal of the two-step process to first identify and exclude from consideration funds that are unlikely to pose risks to the financial system, therefore do not warrant further analysis. As noted in the consultation, Step 2 will involve additional risk-based analysis by the securities regulator, given the inherent limitations in the Step 1 metrics. For example, IOSCO correctly points out that "Step 1 metrics do not reflect any margin or collateral posted by a fund in connection with its derivative transactions, whereas margin or collateral reduces the risk a fund may pose to its counterparty." We encourage IOSCO to specify that moving to the second step in the process will only lead to further analysis by the securities regulators, not designation or additional regulation. To that end, we would request additional clarity on how the data gathered in Step 1 will be used in Step 2.

Finally, implementing new reporting standards has been a resource-intensive process across the industry and care should be taken to ensure that any new reporting metrics dovetail into existing standards as smoothly as possible to avoid inconsistent or duplicative data. Furthermore, despite many years of reporting data on leverage in many jurisdictions, the quality and granularity of data reported back to market participants remains low. Providing aggregated data on developing trends and potential emerging risks would be beneficial to funds looking to manage leverage-related risks more effectively.

We appreciate IOSCO promoting various metrics and approaches to measuring leverage in investment funds. While we have some concerns with the use of notional exposure to measure leverage, we are encouraged by the supplemental options presented in the consultation. We look forward to continuing to work with IOSCO and domestic regulators to ensure an accurate analysis of risk among investment funds.

Sincerely,

Tom Quaadman