

MEMO# 31567

January 17, 2019

Draft ICI Comment Letter on IOSCO Leverage Consultation; Member Comments Requested by January 24

[31567]

January 17, 2019 TO: Derivatives Markets Advisory Committee
ICI Global Regulated Funds Committee
ICI Global Trading & Markets Committee
SEC Rules Committee RE: Draft ICI Comment Letter on IOSCO Leverage Consultation;
Member Comments Requested by January 24

As previously reported, the Board of the International Organization of Securities Commissions (“IOSCO”) issued a consultation paper requesting feedback on a proposed framework to assess investment funds’ use of leverage.^[1] The proposed framework is intended to assist regulators in calculating and analyzing leverage in funds in a sufficiently consistent manner, and would be carried out in two steps. Under the first step, national securities regulators would apply certain metrics to measure leverage within funds in their respective jurisdictions. The goal of the first step is to serve as a screening tool that efficiently excludes from any further consideration funds that are unlikely to pose risks to the financial system. The second step would involve further analysis of the remaining subset of funds.

ICI’s draft comment letter on the consultation is attached for your review. **Please provide any written comments to Ken Fang at kenneth.fang@ici.org by close of business on Thursday, January 24.** Comments on the consultation are due to IOSCO by February 1, 2019.

The draft letter strongly supports the consultation and the goals of facilitating more meaningful monitoring of leverage for financial stability purposes. It notes that regulated funds currently have legal and regulatory limitations on their ability to use leverage and that those limitations, together with other structural and regulatory features, have made it unlikely for a regulated fund to transfer leverage-related risks to its counterparties or the financial system at large.

The letter provides comments in three main sections. Section I provides general observations supporting the consultation’s two-step approach to analyzing leverage in funds and the flexibility that it would provide each national securities regulator to determine what information should be calculated, collected and analyzed.

Section II provides comments on the first step of the framework to more effectively evaluate funds for financial stability risks. In that section, we recommend: eliminating the use of unadjusted gross notional exposure as a leverage metric; allowing duration adjustments to a ten-year bond equivalent; and permitting netting of close-out and offsetting transactions and transactions based on duration equivalency, and the exclusion of certain “direct hedging” transactions. In addition, the section strongly supports IOSCO’s proposed asset classification table, with modifications to eliminate the aggregate “Totals” row and “Percent of Net Asset Value” columns, as a means of better informing national securities regulators about a fund’s leverage-related risks. We also encourage national securities regulators to include as many of the supplementary data points as possible in Step 1, while avoiding the temptation of placing too much emphasis on any one data point (e.g., size of a fund).

Section III provides comments on the second step of the framework. There, we express our general support for the list of potential Step 2 metrics and recommend that IOSCO consider adding a stress-based leverage/worst-loss measure as part of those metrics. We also express support for IOSCO’s non-exhaustive list of Step 2 supplementary data points and its overall approach on data points.

Kenneth Fang
Assistant General Counsel

[Attachment](#)

endnotes

[1] See IOSCO, IOSCO Report: Leverage (November 2018), *available* at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD615.pdf>. For a summary of the consultation, please see ICI Memorandum No. 31511 (Dec. 3, 2018), *available* at https://www.ici.org/my_ici/memorandum/memo31511.