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| Response Form to the Consultation Paper |
| Guidelines on Article 25 of Directive 2011/61/EU |

**Responding to this paper**

ESMA invites comments on all matters in this consultation paper and in particular on the specific questions summarised in Annex I. Comments are most helpful if they:

* respond to the question stated;
* indicate the specific question to which the comment relates;
* contain a clear rationale; and
* describe any alternatives ESMA should consider.

ESMA will consider all comments received by **01/09/2020.**

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input - Consultations’.

**Instructions**

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation Paper in the present response form.
2. Please do not remove tags of the type <ESMA\_QUESTION\_PFG\_1>. Your response to each question has to be framed by the two tags corresponding to the question.
3. If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.
4. When you have drafted your response, name your response form according to the following convention: ESMA\_PFG\_nameofrespondent\_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA\_PFG\_ABCD\_RESPONSEFORM.
5. Upload the form containing your responses, in Word format, to ESMA’s website ([www.esma.europa.eu](http://www.esma.europa.eu) under the heading “Your input – Open consultations” 🡪 “Consultation on Position limits and position management in commodities derivatives”).

**Publication of responses**

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

**Data protection**

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading [Legal Notice](http://www.esma.europa.eu/legal-notice).

**Who should read this paper**

This document will be of interest to asset managers managing alternative investment funds and their trade associations.

**General information about respondent**

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| --- | --- |
| Name of the company / organisation | Irish Funds Industry Association |
| Activity | Investment Services |
| Are you representing an association? |  |
| Country/Region | Ireland |

**Introduction**

***Please make your introductory comments below, if any***

<ESMA\_COMMENT\_PFG\_1>

The Irish Funds Industry Association (Irish Funds) is the representative body for the international investment fund community 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.

Ireland is a leading centre for the domiciliation, management, and administration of collective investment vehicles, with industry companies providing services to collective investment vehicles with assets totalling in excess of €4.9 trillion (as of June 2020). The funds industry is highly regulated and the ability to provide a well-regulated environment for investment funds and investment fund services is a substantial and proven part of Ireland’s international financial services offering.

We welcome the opportunity to provide comment on the consultation paper on Guidelines on Article 25 of Directive 2011/61/EU (“Guidelines”).

<ESMA\_COMMENT\_PFG\_1>

**Questions**

1. : What are your views on the frequency at which the risk assessments should be performed by NCAs?

<ESMA\_QUESTION\_PFG\_1>

The ESRB recommendation E(1) referenced within the consultation paper suggests, “NCAs should perform the risk assessment on a quarterly basis in line with Article 110(3)b-c of Commission Regulation 231/2013”, but also states, “AIFMs shall provide NCAs with the AIFMD data reporting on a quarterly basis for the leveraged AIFs they manage”. Given the focus is on “leverage-related systemic risk” there should not be a disproportionate increase in reporting burdens on firms who currently are not required to report leverage on a quarterly basis. The existing approach under Article 110 of Commission Regulation 231/2013, whereby reporting frequency is dictated as either quarterly, semi-annually, or annually, is sufficiently focused, thereby ensuring AIFs and AIFMs above a certain size already report quarterly.

Therefore, we believe that the current reporting frequency, which includes information on leverage is sufficient, and would allow NCAs to also perform their risk assessments on the most systemically important AIFMs and AIFs (based on the current AUM thresholds as defined in Article 110 of commission regulation 231/2013) on a quarterly basis.

<ESMA\_QUESTION\_PFG\_1>

1. : What are your views on the sample of funds to be included under Step 1? Do you agree in including in the risk assessment not only substantially leveraged funds but also funds not employing leverage on a substantial basis which may pose financial stability risks?

<ESMA\_QUESTION\_PFG\_2>

Irish Funds supports a 2-step approach, as proposed by ESMA, and would advocate for consistency with the recommended process in the IOSCO December 2019, “Recommendations for a Framework Assessing Leverage in Investment Funds” report.

However, given the focus of the consultation is on Article 25 of Directive 2011/61/EU, which refers to leverage, it seems counterintuitive to include funds in step 1 that do not employ leverage on a substantial basis (paragraph’s 13b and 13c).

In addition, setting the regulatory AUM threshold to €500m, per paragraph 13b, would likely bring a large number of AIFs into scope, and appear to go beyond the IOSCO recommendations which focuses on funds “more likely to pose risks to the financial system”[[1]](#footnote-2). Large, regulated, UCITS-like AIFs should not be seen to be “more likely” to pose risks to the financial system from a leverage perspective just because of their size.

In addition, point 13c, and subsequently point 14 goes beyond the current 2 step IOSCO recommendations (which as mentioned above is supported by Irish Funds) and should be excluded.

Given this, we believe the proposed approach is too broad in scope and should remain focused on just funds with substantial leverage. Under the proposed Guidelines, a large number of managers and funds would fall into scope, leading to additional reporting which in turn will lead to additional cost for managers, and damage competitiveness in relation to other jurisdictions. We would also note that the KPMG report on the operation of the Alternative Investment Fund Managers Directive (AIFMD) carried out on behalf of the European Commission found its survey data to indicate that the use of high leverage in AIFs is rare.

Irish Funds consider that should paragraph 13b & 13c of Step 1 remain within the Guidelines, that there should be an increase in the minimum AUM threshold to €1bn for paragraph 13b and that a minimum AUM threshold of €1bn should also be included for paragraph 13c in order to avoid too broad a scope of funds in step 1. Irish Funds also consider that should 13c remain within the Guidelines 14a should be removed. The use of a median or average value of leverage to compare AIFs of the same type does not take account of underlying strategy, instruments or leverage mechanisms employed.

<ESMA\_QUESTION\_PFG\_2>

1. : Do you agree with the proposed threshold identified under Step 1? Would you set the same threshold for all AIFs, or would you be in favour of setting different thresholds based for different types of AIFs (e.g.: real estate, hedge funds, private equity etc) or sub-types of AIFs (please specify) based on a statistical analysis (e.g. percentile)? Should you prefer the latter option, please provide proposals and detailed arguments and justification supporting them.

<ESMA\_QUESTION\_PFG\_3>

Per our answer in question 2, Irish Funds believe that the thresholds introduced should focus solely on funds with substantial leverage. Again, we would point to the fact that Article 25 relates to leverage and therefore would reiterate our belief that funds with low levels of leverage should not be in scope based solely on their size. Introducing leverage limits will not mitigate systemic risk for those funds with little or no leverage as by definition these funds will pose little risk from a leverage perspective.

Enhanced reporting for substantially leveraged funds is already provided to NCAs as part of the Annex IV reporting required under AIFMD. An additional threshold based on AIF AUM size e.g. >€1bn could be used to further filter funds that require further analysis as part of step 2. This ensures a focus on those funds that could have systemic implementations due to both their leverage and resultant AUM.

Additionally, in relation to any leverage calculation requirement there should be an exclusion for subscriptions facilities for closed-ended funds where exposure is covered by capital commitments given that this does not genuinely generate leverage.

Consideration could also be given to the type of strategy and leverage being employed (as opposed to just fund type). For example, funds that trade in interest rate swaps (“IRSs”) will portray higher degrees of leverage as a result of the AIFMD leverage methodology.

In order to get a full picture of the leverage employed by a fund, it is important to consider not only the various leverage calculation methodologies but also the basis on which a portfolio is being managed.

Finally, Irish Funds does not see a need for different thresholds to be set for different funds but do think the underlying leverage generated by certain instrument types (e.g. IRSs) needs to be considered.

<ESMA\_QUESTION\_PFG\_3>

1. : Would you identify other relevant transmission channels?

<ESMA\_QUESTION\_PFG\_4>

No, Irish Funds have not identified any additional transmission channels beyond those referenced in table 2 of the consultation (e.g. market Impact, risk from fire sales, risk of direct spill-overs to financial institutions and risk of interruption in direct credit intermediation).

<ESMA\_QUESTION\_PFG\_4>

1. : What are your views on using not only leverage indicators, but also other types of indicator such as those indicated under Table 2 of the draft Guidelines? Do you agree with the list of indicators provided?

<ESMA\_QUESTION\_PFG\_5>

The gross and commitment leverage calculations (per AIFMD) should be the only indicators used in Step 1, and we would therefore suggest the removal of the adjusted gross leverage and financial leverage indicators. Also, as the gross method will likely overstate the true leverage and market risk, we agree that this should be considered in combination with the commitment method calculation.

Other indicators in Table 2 should not be used in Step 1, as the use of the gross and commitment methods should be sufficient for identifying the level of leverage within a fund. In addition, the focus, in line with Article 25 should be on leverage and there appears to be indicators in table 2 that are not related to leverage included.

It should also be noted that funds that are identified as needing further assessment under step-2 do not necessarily pose systemic risk and qualitative consideration must be given to the fund’s strategy, risk profile and the funds investors’ expectations i.e. certain investors will invest based on certain criteria, set leverage limits being one. It is important to avoid procyclical effects which might occur as a result of clients redeeming following a forced deviation from the expected fund design (e.g. adjusted leverage limits).

We would also ask ESMA to provide greater clarity on what is meant by “Group of AIFs (Funds)” as currently this is unclear. We believe that leverage limits should apply at the AIF level only, as even where funds employ similar strategies the impact of leverage may be different depending on the different variables specific to each fund (e.g. investor type, investment concentration, counterparty exposure) and therefore grouping AIFs based solely on a broad criteria is not appropriate.

Should the concept of “Group of AIFs” be retained in the final Guidelines then, given AIFs will be regulated by the local NCA they are domiciled in, it is essential all NCAs have a harmonised understanding and approach (based on clear criteria). Co-ordination among NCAs is essential to ensure a level playing field and avoid leverage limits being put in place in one jurisdiction but not another.

<ESMA\_QUESTION\_PFG\_5>

1. : What are your views on using not only AIFMD data but also other external data sources to perform the assessment? Which types of external data sources would you consider more useful for the purpose of performing the assessment under Step 2, other than those already identified in Annex of to the draft Guidelines?

<ESMA\_QUESTION\_PFG\_6>

Irish Funds have not identified any other additional data sources outside of what is referenced in table 2.

We would note though that we consider there is no need for new or additional reporting requirements in order for NCAs to meet the new Guidelines. Irish Funds consider that there should not be any additional fields added to the existing Annex IV report, and that this data (along with other existing data provided to national central banks) is of sufficient quality and depth to be used by NCAs for the purpose of performing the assessment under step 2.

Any changes contemplated need to be carefully considered on a cost-benefit basis (considering both sunk and additional costs). Changes to the Annex IV template will have significant costs implications - including data sourcing, aggregation, editing XML for both managers, and the NCAs consuming the data.

<ESMA\_QUESTION\_PFG\_6>

1. : Which other restrictions would you consider as appropriate?

<ESMA\_QUESTION\_PFG\_7>

Irish Funds do not believe any other restrictions should be added, and that any restrictions need to be considered holistically to avoid unintended consequences.

<ESMA\_QUESTION\_PFG\_7>

1. : What are your views on the application of the leverage limits? Should those be applied only on the single fund or, where appropriate, limits should also be applied on group of funds? In this case, how would you identify the group of funds?

<ESMA\_QUESTION\_PFG\_8>

Per our response to question 5, Irish Fund’s preference would be to apply leverage limits at single fund level. As mentioned in question 5 this allows individual fund characteristics to be considered as opposed to limiting leverage on the basis of being part of a “group of AIFs (Funds)”. Individual funds will have different characteristics, be it risk profile, investor type, portfolio make up etc… and this must be considered where leverage limits are imposed. Therefore, applying leverage limits at a group level may also unfairly limit or penalise some funds where another fund in the group gets into difficulty.

The application of a leverage limit at a group level also seems to be at odds with investors having full information about a fund when they invest and having an input into any material changes to those terms.

Applying leverage limits at the “group of funds” level may also lead to an unlevel playing field within Europe if leverage limits are applied on an NCA by NCA basis. If the concept of “group of AIFs (funds)” is kept within the final Guidelines it is imperative that the term “group of AIFs (funds)” is properly clarified and defined.

Additionally, there will need to be a coherent and robust framework to allow NCAs to co-ordinate appropriately to ensure maximum harmonisation of approach regarding leverage limits and avoid an unlevel playing field occurring as mentioned in question 5.

<ESMA\_QUESTION\_PFG\_8>

1. : How would you assess the efficiency of leverage limits in mitigating excessive leverage?

<ESMA\_QUESTION\_PFG\_9>

AIFMD already defines what is substantial leverage, requiring additional reporting for funds that fall in scope. This allows NCAs to consider substantial leverage on an individual fund basis.

This could be further enhanced by considering what is driving the leverage, and the impact this may have on systemic risk. For example, NCAs may consider leverage which increases exposure to emerging markets differently to leverage resulting in increased interest rate exposure. This data should already be available as part of an AIFs/AIFMs periodic Annex IV reporting and therefore should not require any additional reporting by industry.

The application of any leverage limits set by an NCA (under Article 25 (3)) for an AIF should also only be imposed post discussion with the AIFM and considering the parameters of the fund.

<ESMA\_QUESTION\_PFG\_9>

1. <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD645.pdf> (recommendation 1) [↑](#footnote-ref-2)