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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 | State Street Global Advisors |
| Activity | Investment Services |
| Are you representing an association? |  |
| Country/Region | Europe |

**Introduction**

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

<ESMA\_COMMENT\_PFG\_1>

State Street Global Advisors (SSGA) welcomes the opportunity to provide comments on ESMA’s consultation on proposed Guidelines (“the Guidelines”) on Article 25 of the EU Alternative Investment Fund Manager’s Directive (AIFMD) and, more specifically, regarding the assessment of leverage-related systemic risk and the use of leverage limits. SSGA is one of the largest asset managers in the world, with $3.05[[1]](#footnote-2) trillion in assets under management, as of 30 June 2020. For four decades, SSGA has served the world’s governments, institutions and financial advisors, using a rigorous and risk-aware approach to create cost-effective solutions. In that time, we have been and remain pioneers in index, ETF and ESG investing.

SSGA is broadly supportive of the objectives of the Guidelines, namely to develop a consistent approach in the assessment of leverage-related systemic risk by national competent authorities (NCAs) and in the calibration of leverage limits. We also welcome ESMA’s decision to enshrine the principle of proportionality in the Guidelines, particularly regarding the imposition of leverage limits. We do not regard the lack of use or “operationalisation” of leverage limits to be an indicator of a flaw in the current regulatory framework or the approach taken by NCAs; rather, we believe it is recognition that they should only be imposed in exceptional circumstances and where deemed necessary, as foreseen by the AIFMD.

SSGA strongly supports international consistency, in particular with the framework outlined by the International Organisation of Securities Commissions (IOSCO) to assess leverage in investment funds, published in December 2019. We believe this will provide certainty to market participants and also limit the potential that EU-based market participants are subject to additional burdens, which may ultimately affect their competitiveness. In this regard, we welcome the two-step approach proposed in the Guidelines. Notwithstanding this, we would like to highlight and reiterate two core principles: firstly, that the size of a fund, in terms of assets under management (AUM), should be not be the primary determinant of whether that fund is considered to pose a risk to financial stability. Secondly, investment funds that are identified for further analysis under Step 2 should not automatically be regarded as a potential source of systemic risk. We also note that in some areas, ESMA’s Guidelines are more prescriptive and may also have a broader scope than the IOSCO framework.

In addition, we are a firm believer of evidence-based policymaking and we note that the topic of leverage has been an area of focus for a number of years, both within Europe and at international-level. In particular, we would refer to the report published by KPMG[[2]](#footnote-3) on behalf of the European Commission, which stated that the use of high leverage by AIFs is “rare”. We note that the KPMG Report incorporated and reflected views of a number of stakeholders, including NCAs. In addition, to date, the current COVID-19 crisis has not highlighted significant issues regarding the use of leverage by investment funds. We believe ESMA should take note of these elements in its further consideration of the Guidelines.

Furthermore, regarding the broader objective of assessing financial stability risks related to the use of leverage, we would encourage policymakers to adopt a holistic approach. We do not believe focusing solely on indicators of the aggregate use of leverage will enable NCAs to definitively identify areas in the system where there is an accumulation of risk. Rather, NCAs will need to consider the broader ecosystem, including the source(s) of the leverage. For example, in the case of financial leverage, there may be a need to assess the lender and the criteria they use to lend to investment funds.

Please see below for more detailed comments in response to the questions, which we hope are useful in developing the final Guidelines. Should you wish to discuss any aspect of our response, please do not hesitate to contact us.

<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>

SSGA is of the view that the undertaking of risk assessments by NCAs should not impose significant additional requirements on market participants relative to current regulatory obligations. We note that Article 110 of Commission Delegated Regulation (EU) No. 231/2013 currently permits AIFMs to report on either a quarterly, half-yearly or annual basis, determined by the assets managed by the AIFM as well as information on leverage. We believe there is little reason for this to be changed.

As such, while we support NCAs performing risk assessments on a quarterly basis, we are not supportive of AIFMs having an obligation to report on quarterly basis where they have not been required to do so previously, in accordance with Article 110.

The reporting frequency is undoubtedly related to the scope of funds to be considered in the proposed Step 1. The more targeted the scope, the less likely the issue described above will be a concern, given that AIFMs that are most relevant from a leverage-related systemic risk perspective will likely have already been reporting on a quarterly basis. We expand on our concerns regarding scope further below.

<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>

As highlighted in our initial comments, we are supportive of ESMA developing a consistent approach with that taken by IOSCO. However, we believe the scope of funds captured under Step 1 of ESMA’s Guidelines would be significantly broader than funds captured under the IOSCO framework. If the intention is to identify potential systemic risk arising from the use of leverage, then we see little justification for the inclusion of funds that do not employ leverage on a substantial basis under Step 1. The use of leverage by investment funds on a “substantial basis” is a well-established and easily recognised concept within EU legislation; we see no reason to depart from this, in the context of these Guidelines, and believe it should be the key criteria for Step 1.

In addition, we have concerns with point c) of paragraph 13 of the draft Guidelines, under which NCAs should identify funds with “unusually high” use of leverage. The term “unusually high” is not a defined legal concept that already exists and we believe it risks unnecessarily introducing ambiguity. If an investment fund is using leverage to a greater extent than other similar types of AIFs or than it has done in the past but in either case, the level of leverage is not used on a substantial basis, we believe it is unlikely to pose system-wide risk; we would therefore question the rationale behind its inclusion.

It may also be unduly subjective and result in national divergences. For example, where an AIF uses leverage in a jurisdiction in which the use of leverage is not commonplace, it may be identified under Step 1 even though its use of leverage is not materially different to other similar funds across the EU. As a result, this may undermine ESMA’s objective of establishing a consistent approach across the EU.

<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>

In line with our previously highlighted concerns regarding scope and notwithstanding our views that the focus of Step 1 should be investment funds that use leverage on a substantial basis, SSGA is of the view that the €500 million threshold set out in point b) of paragraph 13 is too low. We believe that funds of this size that are not using leverage on a substantial basis are unlikely to pose system-wide or financial stability risks.

Should ESMA be minded to retain this criterion, whereby it effectively makes use of a ‘sliding scale’, we believe the quantitative threshold should be considerably higher. We would also like to reiterate our previous comment that the size of an investment fund in and of itself should be not regarded as an indicator of systemic risk.

<ESMA\_QUESTION\_PFG\_3>

1. : Would you identify other relevant transmission channels?

<ESMA\_QUESTION\_PFG\_4>

SSGA believes that the transmission channels identified by ESMA are appropriate and we do not have any further suggestions in this regard.

<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>

SSGA recognises that, when considering potential leverage-related risks to financial stability, solely focusing on the use of leverage by investment funds may not provide a holistic view and that there is merit in qualitatively considering broader indicators. However, when doing so and for the purposes of these Guidelines, there must be a clear and unambiguous link between the chosen indicator(s) and leverage. Currently, we do not believe all the indicators identified in Table 2 of the proposed Guidelines do have such a link to leverage and that the full set of indicators is unnecessarily wide.

Without prejudice to the above, SSGA believes it is important that policymakers recognise the potential limitations of an overtly quantitative approach. The information provided by AIFMs and the subsequent assessment undertaken by NCAs is likely to be based on assumptions and will only provide an *ex-post* view of market conditions, given the speed at which financial markets can move. In addition, the analysis and assessment may reflect elements that are beyond the control of the AIFM. Therefore, while the Guidelines will undoubtedly be helpful, we believe they will be of more limited value when trying to determine future market stress and indeed where it may crystallise.

<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>

SSGA appreciates that external data sources may be useful in providing NCAs with the macro-economic and broader perspective of financial stability risks. However, it is not clear how these additional external sources would facilitate an NCA’s understanding of potential leverage-related risks. Similarly, this may create data reconciliation issues, which will need to be resolved, creating additional challenges for NCAs.

For the purpose of these Guidelines, we would therefore encourage ESMA to focus on data already provided for in the context of the AIFMD. Rather than considering additional data sources, it may be more useful to seek to address any discrepancies with regards to quality and consistency of the data that NCAs currently receive.

<ESMA\_QUESTION\_PFG\_6>

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

<ESMA\_QUESTION\_PFG\_7>

SSGA welcomes the emphasis in the consultation and the proposed Guidelines that leverage limits should only be used following a detailed assessment on their likely effectiveness. At this stage, we do not believe there is a need for additional restrictions.

<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>

SSGA recognises that, in certain circumstances, policymakers may need to take action to mitigate undue risks to financial stability. At the same time, we are fully supportive of the principle that the manager of an investment fund remains in the best position to determine whether extraordinary tools should be employed for funds under its responsibility, in the interests of investors and taking into consideration the characteristics of that particular investment fund. As such, we believe that measures taken by policymakers and NCAs to impose restrictions on a fund’s investment operations, including the imposition of leverage limits, should only be done so in exceptional circumstances and where other potential avenues have been exhausted.

We believe this is consistent with the Level 1 text of the AIFMD and the intention of co-legislators, which states that leverage limits should only be used where deemed “necessary”. A cautious approach regarding the imposition of leverage limits is also justified by the potential for unintended consequences.

Given the assessment in both Step 1 and Step 2 of ESMA’s proposed framework will be conducted at the individual fund level, we believe any consideration of imposing leverage limits should also be at the individual fund level. In the absence of further specification from ESMA, we see little rationale for imposing leverage limits on a “group of funds” which only share nominal characteristics, particularly where such funds are managed by different AIFMs.

<ESMA\_QUESTION\_PFG\_8>

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

<ESMA\_QUESTION\_PFG\_9>

We welcome the focus on proportionality when assessing the efficiency of leverage limits in delivering against NCA’s objectives. Given the potential for unintended consequences and subsequent market disruption, as a result of imposing leverage limits, we believe the assessment, or at least part of it, should be completed *ex-ante*.

In addition, we would like to highlight that “excessive leverage” is an ambiguous term that is not established in investment terminology or EU fund legislation. As such, it may be subjective and open to interpretation, thereby undermining ESMA’s objective of establishing a consistent approach across the EU. Furthermore, we would question the wording used in the proposed Guidelines. As outlined in Article 25.3 of the AIFMD, the objective of leverage limits is not to mitigate excessive or high use of leverage, but rather where the use of such of leverage poses risks to financial stability and the wider financial system. Therefore, any evaluation on the imposition of leverage limits should be in relation to whether it has prevented the crystallisation of risks to financial stability.

<ESMA\_QUESTION\_PFG\_9>

1. Assets under management as of 30 June 2020 includes approximately $67 billion of assets with respect to which State Street Global Advisors Funds Distributors, LLC (SSGA FD) serves as marketing agent; SSGA FD and State Street Global Advisors are affiliated. [↑](#footnote-ref-2)
2. Report on the Operation of the Alternative Investment Fund Managers Directive (AIFMD) - FISMA/2016/105(02)/C [↑](#footnote-ref-3)