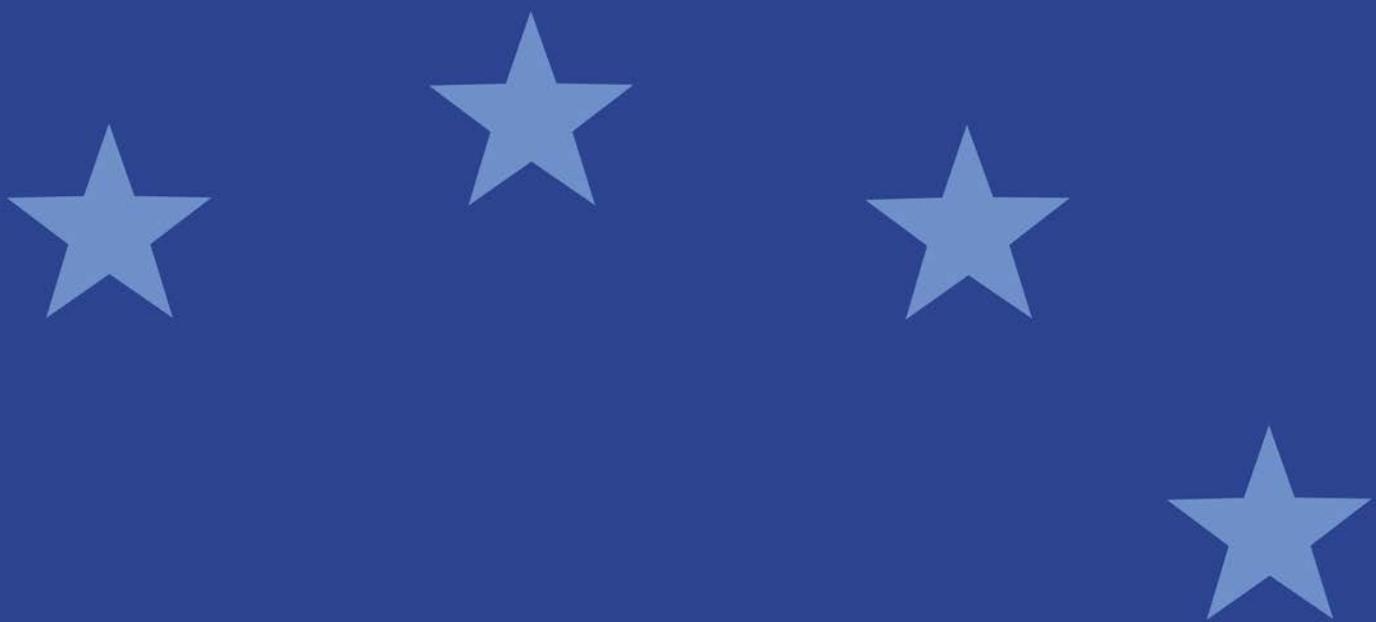




European Securities and
Markets Authority

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 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 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 under the heading [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

Name of the company / organisation	AFG
Activity	Investment Services
Are you representing an association?	<input checked="" type="checkbox"/>
Country/Region	France

Introduction

Please make your introductory comments below, if any

<ESMA_COMMENT_PFG_1>

AFG¹ welcomes positively the objective of practice harmonisation between NCAs as ESMA has a real convergence role to play. We totally agree with ESMA's analysis on the need to have further convergence between NCAs and its continued efforts in the field.

At the same time, we believe that such a convergence exercise will be successful only if several pre-requisites are fulfilled, as described below:

1. AFG believes that what is needed as a first step is to ensure that the current process and framework is fully operational and effective before introducing any additional rules on AIFs' leverage. Indeed, for example, in order to use AIFM data, the homogeneity of formats for the different fields should be a priority. Although we acknowledge ESMA's efforts, **standardisation of the reporting format** for leverage figures such as using the form of a percentage (or not) is a **prerequisite** for any comparative analysis.

2. The « systemic risk » is a complex and multivariate concept. It is not straightforward to deduct when risks at individual level might have systemic repercussions. Besides, is it relevant to consider that higher leverage always amounts to higher risk? It is essential for our members to explain why a fund uses leverage and its value added to the fund performance associated with the appropriate risk management. From a general standpoint, an efficient risk

¹ The Association Française de la Gestion financière (AFG) represents and promotes the interests of third-party portfolio management professionals in France. It brings together all asset management players from the discretionary and collective portfolio management segments.

management policy, well documented and supervised by the regulator is probably to be considered in priority.

3. Priority should be to **define a robust framework without being overly complex**. Indeed, over-complexity should be avoided and sufficient flexibility should be preserved for the following reasons:

- We think complexity is an issue as there is too much information asked by the consultation that goes beyond Article 25 of AIFMD with external data and even potential extension beyond the scope of substantially leveraged funds, already defined in the Level 1 Directive. It is very important to avoid adopting rules that might prove to be heavy and costly to implement for the industry, especially if the question of the effectiveness of imposing limits is visibly still open (last question of the consultation). It is also useful to ensure that NCAs will be able to exploit fully the information given to decide relevant actions with the objective of systemic risk avoidance.
- These questions are even more important in the aftermath of the sanitary crisis. It must be avoided to adopt heavy time-consuming frameworks while the priority in a crisis period is to be given to urgent matters where the human capital is best employed. It is difficult to see how such a complex scheme may be easily and effectively implemented by NCAs in time of crisis. In addition, we should recall that the current crisis test was again successful in terms of fund leverage containing and that no major dysfunction was reported.
- These Guidelines applicable in the context of the use of Article 25 should consider that the exercise is meant to be done in exceptional cases and for crisis events only. The flexibility and the focus of the assessment are important criteria to take into account so as for the NCA to be efficient. Indeed, Article 25 provides that NCAs "**shall impose** limits to the level of leverage that an AIFM are entitled to employ or other restrictions on the management of the AIF with respect to the AIFs under its management **to limit the extent to which the use of leverage contributes to the build up of systemic risk in the financial system or risks of disorderly markets.**"

4. **The number of funds in the scope should be limited** to the ones that need to be properly supervised (in terms of profile and size) and it should not be required to assess all funds against leverage risk in a systematic way:

- As a reminder, the ESMA's EU AIFs annual statistical reports take stock on the fact that AIFs make little use of financial or synthetic leverage and that the majority of AIFs are not HF-like funds, but more domestic UCITS-like type of funds. As indeed, most of the public AIF are UCITS like, the identification process of risky funds for the financial systems is of paramount importance for the efficiency of these guidelines. Embarking the other funds in this heavy process would be costly, useless and may even make difficult and lengthy the identification of those few excessively leveraged funds that may really need to be dealt with.
- The scope of Article 25 is not linked to a general assessment, but the identification of potential systemic risk, which is not stemming from low leveraged funds whatever their size. It is the combination of a more than substantially leveraged fund and its scale. This exercise should concentrate to the needs of Article 25 only, ie prepare to deal with exceptional cases only with regards to systemic risk/disorderly markets risk stemming from excessive use of leverage. For systemic risk in general or stemming from other types of risks, NCAs have already the possibility to act in order to protect markets.

5. Our members wonder if it is relevant to apply, in addition to the **sectoral regulation** that is the most relevant and appropriate approach, a **macro-prudential approach** in the EU to the asset management industry for the following reasons:

- The asset management industry is quite different from the banking one and does not require to have a transversal approach as for a bank. It seems more relevant to use a **targeted approach** that is adapted to a one-by-one fund assessment, and only for the funds that have a significant leverage. From a general standpoint, an efficient risk management policy, well documented and supervised by the regulator is to be considered in priority.
- Such an approach would create a **competitive disadvantage** for the EU industry. In this aspect, it is not aligned with the spirit of IOSCO recommendations published in December 2019, aiming among other things to ensure similar application by all NCAs globally. In addition, the macro-prudential approach as incorporated in the draft guidelines has not been retained in any other jurisdictions nor regions at this stage.

6. Ultimately and more generally, we consider that the focus should be on the **existing data** and that new reporting requirements are not needed as such. If NCAs want to have a comprehensive view of risks involved in all AIFs, they can for instance make use of **the fund inventories** that we already provide on a monthly basis to some central banks and regulators in the EU. Thus, NCAs would receive all raw data, and could make their own calculations without additional cost and onus on AIF managers. The care and focus which should be used in this exercise are also pleading to avoid that Europe is overreacting with tougher rules than other markets and places itself in an unfavourable competitive position, as mentioned previously.

<ESMA_COMMENT_PFG_1>

Questions

Q1 : What are your views on the frequency at which the risk assessments should be performed by NCAs?

<ESMA_QUESTION_PFG_1>

The frequency is linked to the scope. The more focused the scope, the more useful and feasible to have a more frequent reporting. It is thus possible to consider that a quarterly frequency is appropriate if the current proposed scope is narrowed to substantial leverage funds that are managing more than € 1 billion assets at the reporting date. In addition, it should be reminded that depending on the AUM, the AIFM reporting may be due on a half yearly or yearly pace.

We also mention that a risk assessment on a quarterly basis is consistent with Article 110(3)b-c of Commission Regulation 231/2013, through which AIFMs shall provide NCAs with the AIFMD data reporting on a quarterly basis for the leveraged AIFs they manage.

<ESMA_QUESTION_PFG_1>

Q2 : 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>

No, we don't agree to including in the risk assessment not only substantially leveraged funds (3 times the commitment as defined in AIFMD), but also funds not employing leverage on a substantial basis. Regarding the Step 1, the current scope is **ineffectively too broad**. The current **substantial leverage metric coupled with a size component (minimum € 1 billion) should define the perimeter of funds as of this step (cumulative criteria)**. The third element, c), should be part of Step 2, not Step 1. The first step is to identify risky funds from a systemic risk point of view. So potential substantial leverage coupled with a minimum size are the key elements for this step. Size alone is not a relevant criterion for the current exercise.

The current existing rule on leverage is sufficient for this step. The AIFM Directive has on purpose defined a substantial leverage to capture funds that may need further analysis in terms of systemic risk stemming from leverage. We remind that a vast majority of AIFs are UCITS like funds with little or no leverage. A size component on top (cumulative criteria) of the substantial leverage criterion helps indeed to operationalise efficiently the NCAs work under Article 25.

We would like also to mention that we believe that ESMA should aim to ensure (in this exercise too) consistency with the process recommended in the December 2019 "*IOSCO Recommendations for a Framework Assessing Leverage in Investment Funds*". Indeed, the IOSCO Recommendations are aimed at being applied in the same terms by all NCAs over the world and it is appropriate for ESMA to also propose a risk assessment designed into a two-steps approach. We see however a divergence in the

design of Step 1 which amounts to an extension of the scope for ESMA potentially to all AIFs, whereas IOSCO recommends for the step 1 the identification of funds more likely to cause risks in the financial system and not all funds that may cause risks. “

Recommendation 1 IOSCO: “The goal of Step 1 is to provide regulators with a means of efficiently identifying those funds that are more likely to pose risks to the financial system.”

ESMA Recommendation : “Under Step 1 (Level, source and different usages of leverage), NCAs should identify not only AIF employing leverage on a substantial basis but also non-substantially leveraged AIFs which may cause risks to financial stability and thus need to be assessed under Step 2.”

Our members think that in addition to be ineffective in terms of risk surveillance, a too broad scope in Europe compared to other regions may have negative consequences in terms of competitiveness for EU fund managers, as it will likely be costlier and heavier to implement.

<ESMA_QUESTION_PFG_2>

Q3 : 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>

No, we do not agree with the proposed threshold identified under Step 1.

Please see our recommendations regarding step 1's scope at our answer to the Q2. The assessment of the level of leverage in a given fund is key and AIFMD already provides with the “substantially leveraged funds” distinction which triggers the obligation to provide NCAs with enhanced reportings. The current **substantial leverage metric coupled with a size component (minimum € 1 billion) should define the perimeter of funds as of this step.**

In addition, we do not consider meaningful to assess the risks by setting “types” of funds because it is ineffective in terms of accuracy of category definition. Indeed, attempts to define what is a hedge fund did not succeed in the past and ended to a very broad AIFM Directive. We also mention that member states have very different AIF domestic categories for a same asset class.

<ESMA_QUESTION_PFG_3>

Q4 : Would you identify other relevant transmission channels?

<ESMA_QUESTION_PFG_4>

No.

<ESMA_QUESTION_PFG_4>

Q5 : 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>

No, we think the Guidelines should focus on the leverage indicators only. **The proposal is too broad as it includes other types of risks than the leverage risk, which is a definite, precise and measurable type of risk.**

Our members think that only indicators related to Leverage should be used, in conformity with Article 25 of AIFMD Level 1 and more widely the AIFMD Level 1 provisions related to leverage. The NCA asks, if needed, for further specific and effective information related to a specific fund. Introducing systematically such a series of additional criteria not based on leverage would in addition diverge from the IOSCO's Recommendations, amounting eventually to inconsistent assessment of the same risk depending on the region where the fund is located.

These Guidelines applicable in the context of the use of Article 25 should consider that the exercise is meant to be done in exceptional cases and for crisis events only. The flexibility and the focus of the assessment are important criteria to take into account so as for the NCA to be efficient. Indeed, Article 25 provides that NCAs "**shall impose** limits to the level of leverage that an AIFM are entitled to employ or other restrictions on the management of the AIF with respect to the AIFs under its management **to limit the extent to which the use of leverage contributes to the build up of systemic risk in the financial system or risks of disorderly markets.**"

The idea is not to assess again all funds against leverage risk in a systematic way; the scope of Article 25 is not linked to a general assessment, but to the identification of potential systemic risk, which is not stemming from low leveraged funds whatever their size. It is the combination of a more than substantially leveraged fund and its scale. This exercise should concentrate to the needs of Article 25 only, ie prepare to deal with exceptional cases only with regards to systemic risk/disorderly markets risk stemming from excessive use of leverage. For systemic risk in general or stemming from other types of risks, NCAs have already the possibility to act in order to protect markets.

<ESMA_QUESTION_PFG_5>

Q6 : 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>

The proposal is too much detailed, it is difficult to see how such a complex scheme may be easily and effectively implemented in time of crisis by NCAs.

Regarding the data gathering for the analysis, we would like clarification that new fields to existing AIFM reporting and/or new reporting from management companies are not needed. It is the NCA who makes the data finding exercise based on existing data points from existing fields. In addition, there is always the possibility to access monthly portfolio inventories that are reported to the National Central Banks. There should be no additional request to AIF managers.

Regarding the leverage measures that are calculated and reported, currently there are only two on which the NCAs may base their analysis: commitment and gross leverage as per AIFMD delegated regulation. ESMA mentions additional ones like adjusted gross, which is not an AIFM metric and does not bring any supplementary material added value to the analysis.

Real Estate funds do not all have the same leverage calculation from one members state to the other and it would be interesting to see if there is room to work towards greater European convergence. France for instance has worked on a harmonised set of rules for real estate funds.

Our members think there is no need for additional external data sources other than those already identified in the Annex. The Table in page 32 is considered to use too much information; leverage figures are sufficient.

<ESMA_QUESTION_PFG_6>

Q7 : Which other restrictions would you consider as appropriate?

<ESMA_QUESTION_PFG_7>

We don't see other restrictions to add, the approach is already overly complex.

<ESMA_QUESTION_PFG_7>

Q8 : 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>

We generally think it is the responsibility of each NCA to regulate its own locally domiciled range of AIFs.

We can agree to apply leverage limits to individual funds as part of a group. The group of funds (paragraph 21) should represent a perimeter based on objective criteria. Leverage limits apply at the fund level for each fund in the group.

Any leverage limit should be set up only in exceptional situations and only if the relevant AIFs (inside of a group or not) are specifically identified post Step 1.

These Guidelines applicable to the use of Article 25 should consider that the exercise is meant to be done in exceptional cases and for crisis events. The flexibility and the focus of the assessment are important criteria to take into account so as for the NCA to be efficient. Indeed, Article 25 provides that NCAs "**shall impose** limits to the level of leverage that an AIFM are entitled to employ or other restrictions on the management of the AIF with respect to the AIFs under its management **to limit the extent to which the use of leverage contributes to the build up of systemic risk in the financial system or risks of disorderly markets.**"

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<ESMA_QUESTION_PFG_8>

Q9 : How would you assess the efficiency of leverage limits in mitigating excessive leverage?

<ESMA_QUESTION_PFG_9>

If the first step of assessing the risky funds from a systemic risk point of view is efficiently done then, in case of exceptional circumstances putting leverage limits on identified funds/ funds' group could be efficient.

The example of short selling ban during the recent crisis can be an illustration thereof. In the same manner, the NCAs know their market and ultimately take the responsibility of considering if there is “excessive” leverage² and apply an appropriate measure (which could be in exceptional cases the fact to impose a cap on a specific fund or group of funds) while coordinating with the other NCAs within ESMA. With regards to the monitoring of leverage and the assessment of its potential to become in exceptional circumstances a source of systemic risk, it should be reminded the importance of the thorough application of the IOSCO's Recommendations globally, thus reaching a level playing field.

These Guidelines applicable to the use of Article 25 should consider that the exercise is meant to be done in exceptional cases and for crisis events.

Our members think that NCAs should stick to AIFM data that is already provided in existing AIFM reportings.

There should also be mentioned the issue of cost. A complex framework may prove to be costly and it might hinder competition between market places around the world while not proving their efficiency. Ultimately and more generally, if NCAs want to have a comprehensive view of risks involved in all AIFs, they can for instance make use of the fund inventories that we already provide on a monthly basis to some central banks and regulators in the EU. Thus, NCAs would receive all raw data, and could make their own calculations without additional cost and onus on AIF managers. The care and focus which should be used in this exercise are also pleading to avoid that Europe is overreacting with tougher rules than other markets and places itself in an unfavourable competitive position.

<ESMA_QUESTION_PFG_9>

² “Excessive leverage” is not a notion defined by legislation (neither IOSCO nor AIFM) and this is appropriate knowing that like with the “exceptional circumstances”, defining them is admitting we can forecast the complete spectrum of what may happen in the future and the way to respond...