

27 February 2025

Via online submission portal

Secretariat of the Financial Stability Board  
c/o Bank for International Settlements  
CH-4002, Basel  
Switzerland

**Re: MFA Comments on FSB Consultation – Leverage in Non-bank Financial Intermediation**

Dear Sir or Madam:

MFA<sup>i</sup> appreciates the opportunity to respond to the Financial Stability Board's (the "FSB") above-captioned consultation document: Leverage in Non-Bank Financial Intermediation (the "**Consultation Paper**").<sup>ii</sup>

Nonbank financial institutions ("NBFIs") play an important role in the financial markets by diversifying the sources of financing available to the real economy and contributing to deep, efficient and resilient markets. Nonbanks comprise a broad swath of many different industry participants, including insurance companies, retail investment funds, pensions, family offices, sovereign wealth funds and central banks, foundations, endowments, and alternative asset managers. As a former SEC Chair recently noted, "the nonbank sector provides important alternatives and competition to the banking sector. This competition benefits investors, savers, borrowers, and issuers, as well as banks themselves."<sup>iii</sup> The European Central Bank also noted that "[n]on-banks have remained resilient to recent bouts of market volatility and have continued to support market-based finance in the euro area across all credit risk categories."<sup>iv</sup>

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<sup>i</sup> Managed Funds Association ("MFA"), based in Washington, D.C., New York City, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest it, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 180 fund manager members, including traditional hedge funds, private credit funds, and hybrid funds, that employ a diverse set of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors diversify their investments, manage risk, and generate attractive returns throughout the economic cycle.

<sup>ii</sup> Financial Stability Board, *Consultation Report – Leverage in Non-bank Financial Intermediation* (Dec. 18, 2024), available at <https://www.fsb.org/uploads/P181224.pdf>.

<sup>iii</sup> Gary Gensler, *A Feature, Not a Bug: The Important Role of Capital Markets in the U.S.*, Speech at Bloomberg Global Regulatory Forum, (Oct. 22, 2024), available at <https://www.sec.gov/newsroom/speeches-statements/gensler-remarks-bloomberg-global-regulatory-forum-102224>.

<sup>iv</sup> European Central Bank, *Financial Stability Review* (Nov. 2024), avail. at [www.ecb.europa.eu/press/financial-stability-publication/fsr/html/ecb.fsr202411](http://www.ecb.europa.eu/press/financial-stability-publication/fsr/html/ecb.fsr202411).

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Alternative asset managers in particular have historically contributed to the resilience of global financial markets during times of stress. These tenets should guide the FSB's work as it considers the role NBFIs play in today's markets, so that the broader policy framework continues to support the important role of NBFIs in financial markets and, correspondingly, is designed to avoid unduly restricting NBFIs, which would adversely affect market functioning.

It is critical to note that many alternative asset managers use leverage to enter into derivatives contracts to hedge against interest rate or FX risk, a practice we recommend that regulators encourage. Traditional hedge fund strategies typically vary widely from fund to fund and are uncorrelated with each other in terms of investment style, strategy, and/or geographic focus. Several strategies also require little use of leverage: private credit, for example, does not present the same risks as banks because private credit arrangements tend to involve the use of limited leverage and generally rely on long-term funding, as compared to the high leverage and short-term funding used by banks. In short, alternative asset managers should not be subject to the same regulatory treatment as banks because alternative asset managers have a distinct risk profile that poses significantly less risk to financial stability. Applying one-size-fits-all regulation to banks and NBFIs, including alternative asset managers, therefore, would lead to sub-optimal policies that adversely distort the financial markets.

## **Executive Summary**

In this letter, we outline key themes regarding the alternative asset management industry that the FSB should consider when finalizing its recommendations. In particular, this letter highlights five key themes:

- 1) The unique structure of the alternative asset management industry makes it a source of stability for the financial markets;
- 2) Alternative asset managers do not pose the same risk to financial stability as banks and should not be subject to the same regulatory treatment;
- 3) Financial markets are better served when alternative asset managers and their counterparties use dynamic, flexible risk management and disclosure practices;
- 4) Evaluation of risk metrics should be limited to those that are most appropriate for a given situation, particularly when evaluating leverage; and
- 5) The important role that leverage plays in supporting financial markets and the broader economy.

Attached to this letter is an appendix with more detailed responses to the questions posed in the FSB's consultation.

### **I. The unique structure of the alternative asset management industry makes it a source of stability for the financial markets**

The alternative asset management industry has attributes that help minimize financial stability and concentration risks, which, in turn, help support the important role alternative asset managers play in today's markets. In particular, alternative asset managers engage in a diverse range of investment strategies and the industry is highly

competitive, reflecting relatively low concentration and interconnectedness.<sup>v</sup> Alternative asset managers also manage private credit vehicles, which have been an increasingly stabilizing source of credit for companies of all sizes. Moreover, alternative asset managers have historically relied on a relatively modest amount of leverage to finance trading and hedging positions. Alternative asset managers that tend to employ relatively higher amounts of leverage often do so to invest in less risky assets, such as U.S. Treasuries (“UST”), or to hedge risks within their portfolios.

Alternative asset managers differ from other financial market participants because they manage funds that ultimately are vehicles for the management of others' assets. These funds do not maintain a large balance sheet of their own assets but instead facilitate access for clients to invest in particular financial instruments or strategies. They serve sophisticated, often institutional, investors that understand the liquidity limitations of the fund and are capable of bearing investment risks. During times of stress, if a fund managed by an alternative asset manager were to fail, the fund would wind down without causing significant disruption to financial markets or the broader economy. No closure of such a fund during the 2008 financial crisis or since has threatened market functioning or financial stability.

As important market participants in the capital markets, alternative asset managers should and do apply sound risk management practices, both to minimize risks to their own firm and to the financial markets more broadly. The risk management practices of alternative asset managers, prevailing market structure, and the existing regulatory framework all significantly limit the potential of alternative asset managers to pose a risk to financial stability. Today, the market operates dynamically and effectively to encourage prudent risk management, as alternative asset managers and their bank counterparties are incentivized to help ensure that trading and financing relationships are stable and do not put either party at undue risk. A more prescriptive, regulator-driven approach would disrupt this balance, introduce unnecessary friction, and reduce efficiency and liquidity in the markets. Said differently, applying a regulator-conceived artificial limit on leverage would do more harm than good. At the same time, all market participants would benefit if prevailing best practices in risk management are consistently followed by banks and their counterparties.

## **II. Alternative asset managers do not pose the same risk to financial stability as banks and should not be subject to the same regulatory treatment**

Alternative asset managers should not be subject to the same regulatory treatment as banks because alternative asset managers have a distinct risk profile that poses significantly less risk to financial stability. This point is illustrated by the fact that over 1,000 alternative asset managers close every year,<sup>vi</sup> all without raising systemic concerns. According to a recent analysis by the Board of Governors of the U.S. Federal Reserve System, the failure of five hedge funds with the largest counterparty exposures to the U.S. global systemically important banks would result in losses of only between

<sup>v</sup> See Committee on Capital Markets Regulation, *A Competitive Analysis of the U.S. Hedge Fund Market*, 3 (2023) (concluding that the hedge fund industry is within the lowest decile of industry concentrations for public companies in the United States).

<sup>vi</sup> For context, as of December 6, 2024, over 50,000 alternative asset managers report to the SEC on Form PF. See Securities and Exchange Commission, Division of Investment Management Analytics Office, *Private Fund Statistics* (2024), available at <https://www.sec.gov/files/investment/private-funds-statistics-2024-q2.pdf>.

1.0 and 1.2 percent of those banks' risk-weighted assets.<sup>vii</sup> This analysis demonstrates that even the largest alternative asset managers can fail without posing sizeable risk to their bank counterparties or the broader financial system. In contrast, the failure of a few significant banking institutions can lead to disruption and panic in the financial system, as reflected in March 2023 with the failures of Credit Suisse, Silicon Valley Bank, Signature Bank, and First Republic Bank.

Banks are highly leveraged institutions that engage in maturity transformation, are critical to the functioning of the payments system, and benefit from various governmental guarantees. Alternative asset managers, however, are generally less leveraged and do not deal with the same issues of liquidity mismatch because investors in alternative asset managers have contractually agreed to lock up their investment and, thus, have no ability to withdraw funds on demand. As one example, private credit does not present the same risks as banks because private credit arrangements tend to involve the use of limited leverage and generally rely on long-term funding, as compared to the high leverage and short-term funding used by banks. In contrast, a bank is vulnerable to runs because it is unable to halt depositor withdrawals. During times of stress, for a bank to meet the short-term liquidity demands of its depositors, the bank generally would need to sell long-term assets which can lead to significant losses for the bank. This scenario can create significant risk to the broader financial system and require government intervention. In contrast, alternative asset managers contractually limit investor withdrawals to prevent runs on the fund and to support investments in long-term assets and through market cycles. Alternative asset managers are also less leveraged than banks and hold more liquid assets, reducing their liquidity risk. For example, data from Form PF shows that alternative asset managers do not have the same kind of liquidity mismatch that banks have. In addition, a staff paper published by the SEC in May 2017 noted that most hedge funds have a "negative liquidity mismatch," meaning that those funds hold relatively liquid assets compared to the combined liquidity of their liabilities plus equity.<sup>viii</sup> Further reinforcing this view, the European Securities and Markets Authority published a risk analysis of alternative asset manager leverage in the European Union in January 2024, stating that "[o]n average [hedge funds] report managing assets that can be liquidated in a short time horizon."<sup>ix</sup> Lastly, alternative asset managers do not benefit from deposit insurance or other government support. Accordingly, alternative asset managers, unlike banks, are incentivized to limit their leverage to protect investors and, if an alternative asset manager were to fail, the government would not be responsible for bailing it out.

In light of all of the above, alternative asset managers should not be subject to the same regulatory requirements as banks. Instead, regulators should focus on risk management practices that reflect the unique characteristics of alternative asset managers, their trading and financing strategies, and the benefits alternative asset

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<sup>vii</sup> See *Dodd-Frank Act Stress Test Publications*, FED. RSVE. (July 17, 2024), available at <https://www.federalreserve.gov/publications/June-2024-Exploratory-Analysis-of-Risks-to-the-BankingSystem.htm>.

<sup>viii</sup> See George O. Aragon & A. Tolga Ergun & Mila Getmansky & Giulio Girardi, *Hedge Fund Liquidity Management*, SEC 17 (May 2017), available at [https://www.sec.gov/files/dera\\_hf-liquidity-management.pdf](https://www.sec.gov/files/dera_hf-liquidity-management.pdf).

<sup>ix</sup> See Jean Baptiste, *Assessing the Risks Posed by Leveraged AIFs in the EU*, EUROPEAN SEC. AND MKTS. AUTH. 7-9 (Jan. 30, 2024), available at [https://www.esma.europa.eu/sites/default/files/2024-01/ESMA60-1389274163-2572\\_TRV\\_article\\_-\\_Assessing\\_risks\\_posed\\_by\\_leveraged\\_AIFs\\_in\\_the\\_EU.pdf](https://www.esma.europa.eu/sites/default/files/2024-01/ESMA60-1389274163-2572_TRV_article_-_Assessing_risks_posed_by_leveraged_AIFs_in_the_EU.pdf).

managers bring to markets. As noted above, all market participants would benefit if prevailing best practices are consistently followed by banks and their counterparties. Applying one-size-fits-all regulation to banks and NBFIs, including alternative asset managers, would lead to sub-optimal policies that adversely distort the financial markets.

### III. Financial market participants require dynamic, flexible risk management and disclosure practices

Existing regulations and market practices that have developed since the 2008 global financial crisis allow alternative asset managers and their counterparties to effectively manage counterparty credit risk. Given the diversity in markets, alternative asset managers and their counterparties need flexibility to adopt risk mitigation strategies that are tailored to the particular trading or financing relationships and relevant transactions. In contrast, prescriptive regulator-conceived restrictions are bound to become outdated, failing to reflect ever-changing markets and, in turn, are likely to adversely distort market functioning. For example, bank counterparties that finance basis trades manage their counterparty risk by applying haircuts and margin requirements in a way that is best suited to the risks posed by the unique features of the basis trade. The Federal Reserve affirmed this in their 2023 Financial Stability Report, which said that concerns about risk in the basis trade are being “mitigated by tighter financing terms applied to hedge funds by dealer counterparties over the past several quarters.”<sup>x</sup> If regulators were to require banks to apply minimum haircuts on basis trades, it would increase the cost to finance basis trades, raise borrowing costs for the US government, increase volatility, and reduce liquidity in the UST market, all without meaningfully improving banks’ counterparty risk management.<sup>xi</sup> For a deeper discussion of risk management practices in connection with the cash-futures basis trade, see our response to Question 6 in the attached Appendix. Of course, imprudent use of leverage to take positions in riskier or illiquid assets can pose risks to financial stability. A variety of market practices, often driven by bank counterparty requirements, in addition to regulator requirements, together provide an ample check on the imprudent use of leverage.

For this reason, all market participants comply with a variety of prevailing risk management best practices and regulatory requirements. Regulatory initiatives to address the risks posed by NBFIs leverage, however, can inadvertently distort market incentives and encourage (rather than limit) risk-taking. For example, an analysis by staff at the Bank of England and the Financial Conduct Authority demonstrated that when an alternative asset manager is subject to an entity-level fixed leverage limit it is likely to reallocate its capital from low-risk strategies, such as investing in US

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<sup>x</sup> Board of Governors of the Federal Reserve System, *Financial Stability Report* (October 2023), available at <https://www.federalreserve.gov/publications/files/financial-stability-report-20231020.pdf>.

<sup>xi</sup> Board of Governors of the Federal Reserve System, *Hedge Fund Treasury Exposures, Repo, and Margining* (Sept. 8, 2023), available at <https://www.federalreserve.gov/econres/notes/feds-notes/hedge-fund-treasury-exposures-repo-and-margining-20230908.html> (“[Most] funds already satisfy the collateral requirement and, in our analysis, do not need additional capital to support existing borrowing.... [Imposing leverage limits] may affect the size and volatility of spreads among related instruments in Treasury cash and derivatives markets, as well as market liquidity conditions in those markets.”).

Treasuries, to higher-risk strategies to seek enhanced return.<sup>xii</sup> Similarly, if an alternative asset manager is exposed to assets that are subject to an activity-based limit, such as risk-sensitive margin requirements, the alternative asset manager can choose to pay the additional margin as a risk premium, thereby making it critical that margin and collateral requirements be thoughtfully calibrated to accurately reflect the risk. Regulators, however, do not always appropriately calibrate requirements based on the risk of the activity, resulting in risks either being over- or under-hedged. These outcomes demonstrate the adverse distortions that prescriptive, regulator-conceived restrictions on investment strategies can have. In contrast, financing and dealer counterparties are better positioned than regulators to identify the risks from alternative asset managers and apply suitable measures to manage the corresponding risk.

Along similar lines, regulators should not require prescriptive disclosure requirements or practices between NBFIs and their counterparties. Regulators already require alternative asset managers to disclose information about their activities in the United States and European Union to regulators through Form PF and Annex IV, respectively. Prudential authorities also require banks to disclose information about the activities of their counterparties, either to regulators or through public disclosures – for example, the Federal Reserve’s Financial Stability Report and the Commodity Futures Trading Commission’s (“CFTC”) Commitments of Traders Report.<sup>xiii</sup> For the first time, the Bank of England’s System-Wide Exploratory Scenario Exercise (“SWES”) also aggregated considerable nonbank data to construct a “moment-in-time” snapshot to assess risk to the system under a hypothetical stress scenario.

Although bilateral disclosures to bank counterparties are more useful for bank counterparties to assess their counterparty risk, if regulators decide to require additional disclosures of alternative asset manager activities, it is imperative that regulators only publish aggregated, anonymized data. In particular, we advise against any public position disclosure that would compel investment funds to directly or indirectly publicly reveal their otherwise confidential investment positions and trading strategies.

An alternative asset manager’s investment and trading strategy is among its most closely guarded trade secrets. Academic research has shown that the public disclosure of otherwise confidential investment positions – even on a limited basis and with long reporting timeframes – impairs investment returns and negatively impacts market quality and efficiency. The potential consequences of such disclosures include: (i) facilitating copycatting and free-riding; (ii) allowing other market participants to reverse engineer investment theses and trading strategies; (iii) compromising investors’ ability to establish and risk manage right-sized positions without having outsized market impact; and (iv) reducing incentives to conduct fundamentally driven research. These adverse consequences, in turn, negatively impact

<sup>xii</sup> Leo Fernandes, et. al., *A simple model of the effects of entity and activity constraints on alternative investment funds* (Aug. 2024), available at <https://bankunderground.co.uk/2024/09/04/a-simple-model-of-the-effects-of-entity-and-activity-constraints-on-alternative-investment-funds/amp/>.

<sup>xiii</sup> Bank of England, *System-Wide Exploratory Scenario exercise final report* (Nov. 29, 2024), available at <https://www.bankofengland.co.uk/financial-stability/boe-system-wide-exploratory-scenario-exercise/boe-swes-exercise-final-report>; Board of Governors of the Federal Reserve System, *Financial Stability Report* (Nov. 2024), available at <https://www.federalreserve.gov/publications/files/financial-stability-report-20240419.pdf>; CFTC, *Commitments of Traders*, available at <https://www.cftc.gov/MarketReports/CommitmentsofTraders/index.htm>.

market quality and efficiency by impairing the price discovery process, diminishing market efficiency and liquidity, and undermining the critical role that actively managed investment strategies play in the markets.

Rather than requiring additional regulatory or public disclosures from alternative asset managers, regulators should instead focus their attention on harmonizing and improving the usefulness and efficiency of the regulatory disclosures required in Form PF and Annex IV. Regulators should seek to ensure that data reported from investment funds is harmonized across jurisdictions so that regulators can make an “apples to apples” comparison of fund data. Inconsistent data sets in the Form PF and Annex IV data (for example, inconsistent derivatives trade reporting) severely limits the usefulness of the data. Without accurate data from alternative asset managers that is comparable across jurisdictions, regulators cannot fully understand the strategies, investments, size, and risks of investment funds. In addition to any harmonization efforts, and more broadly, regulators should consider whether the data required to be reported is useful for its intended purposes or, alternatively, whether changes are warranted.

Alternative asset managers also disclose significant information to dealer counterparties as part of negotiating the terms of a trading or other counterparty relationship. At the same time, regulators could play a useful role in establishing principles that bank counterparties should follow when developing their disclosure and risk management practices. For example, prudential authorities may acknowledge and expect that banks should: (i) establish internal standards for the quality and frequency of disclosures; (ii) make risk appetite decisions based on the full range of disclosures provided to the bank; and (iii) condition doing business with the counterparty on the quality of that counterparty’s disclosures.<sup>xiv</sup> These guiding principles could be particularly important in a competitive market, where competitors can require additional information from nonbank counterparties to manage their risk.<sup>xv</sup> By establishing risk management principles based on prevailing best practices, regulators can enhance disclosures and help ensure that all market participants maintain the same high standards for risk management that established bank counterparties currently follow. At the same time, these principles would still preserve flexibility for banks to determine the disclosures that are appropriate for each counterparty and trading or financing relationship.

Regulators should not, however, dictate the specific disclosures that banks require from their counterparties. Critically, alternative asset managers should not be required to disclose position-specific information to bank counterparties on positions held by other banks. Prevailing risk management practices do not require alternative asset managers to share position-specific information with their bank counterparties because doing so would transform the relationship between alternative asset managers and their bank counterparties by harming important commercial objectives. Such information is highly sensitive and disclosing the size and scope of confidential relationships with third-party banks would reveal information about closely guarded trading and counterparty diversification strategies of alternative asset managers that are intentionally structured to mitigate the risk of such disclosures. Counterparties are

<sup>xiv</sup> Rebecca Jackson, Executive Director, Bank of England, *Prime brokerage* (Jan. 28, 2025), <https://www.bankofengland.co.uk/speech/2025/january/rebecca-jackson-speech-at-uk-finance-prime-brokerage>.

<sup>xv</sup> *Id.*



already well-positioned to require additional information from nonbank counterparties as their own risk management practices dictate.

Bank counterparties are better positioned than regulators to know what information they need from their counterparties to manage credit risk. Counterparties are also able to negotiate the appropriate information to share with each other in a dynamic environment. As markets shift and new or different information becomes relevant to prudent risk management, counterparties can adjust what they share with each other accordingly. For example, the Federal Reserve’s Senior Credit Officer Opinion Survey (“**SCOOS**”) is a market-driven tool that allows regulators and market participants to obtain information about financing markets and changing market dynamics that they use to manage risk. Most recently, for instance, the SCOOS indicated that use of leverage remains “basically unchanged” in securities financing and over-the-counter (“**OTC**”) derivatives transactions.<sup>xvi</sup> In contrast, prescriptive disclosures mandated by governmental authorities are unlikely to be dynamic in this way and may or may not initially provide the appropriate information for risk management purposes. As a result, regulator-driven risk management designs very well may have the effect of creating a check-the-box environment that distorts markets and behaviors and does not serve its intended purpose of enhancing risk management practices.

#### **IV. Evaluation of risk metrics should be limited to those that are most appropriate for a given situation, particularly when evaluating leverage**

For the FSB to appropriately consider risks in financial markets, regulators should rely on metrics that are best suited to the parties and the trading or financing relationship. This would include considering use of net and adjusted measures that are currently available to regulators. Gross notional exposure (“**GNE**”), without appropriate netting and adjustments, presents an incomplete and likely misleading view of a firm’s risk. Rather than relying on GNE, regulators should use more comprehensive risk metrics currently available to them, such as those that account for netting and adjustments, to assess risk. This will allow regulators to more accurately assess a fund’s true market or counterparty exposure. Regulators should also tailor the metrics they rely on to match the risk profiles and strategies of the market participants and the trading or financing relationship. Relying on risk metrics that provide a more complete understanding of a market participant’s risk profile and that are tailored to the situation will assist regulators in developing policies that appropriately reflect the amount of risk in the NBFIs industry.

As an example of the flawed gross risk metrics discussed above, regulators should not use gross synthetic leverage metrics to assess the risks associated with derivative positions. As stated by the Bank of England, “GNE is not informative about the potential losses and liquidity demands that a fund could face” with respect to synthetic leverage because GNE does not consider the sensitivity of derivatives to different risk factors, offsetting exposures to derivative positions, or the purpose of a derivative exposure to increase or hedge risk.<sup>xvii</sup> Therefore, to avoid providing regulators

<sup>xvi</sup> Board of Governors of the Federal Reserve System, *Senior Credit Officer Opinion Survey on Dealer Financing Terms* (Dec. 2024), available at [https://www.federalreserve.gov/data/scoos/files/scoos\\_202412.pdf](https://www.federalreserve.gov/data/scoos/files/scoos_202412.pdf).

<sup>xvii</sup> Bank of England, *Public Comment on IOSCO Report: Leverage*, 4 (2018), available at <https://www.iosco.org/library/pubdocs/615/pdf/Bank%20of%20England.pdf>.



with an inaccurate impression of the risks associated with these positions, rather than requiring that bank counterparties report gross synthetic leverage from derivative positions with alternative asset managers, regulators should instead focus on adjusted synthetic leverage which more accurately reflects risk.

Instead of using gross metrics to assess risk, regulators should rely on available risk metrics that are appropriately tailored to the risk profile of the market participants and any particular trading and financing relationship. The financial markets are vast and diverse. As a result, different metrics should be used to measure leverage in different situations. A one-size-fits-all approach to measuring leverage cannot accurately assess the risk of market participants with such different strategies. In the global alternatives industry, there are many types of market participants, including hedge funds, private credit funds and other alternative investment funds, each of which rely on different investment, trading, arbitrage and hedging strategies that require unique metrics to appropriately assess their risk. In some cases, it is appropriate to haircut collateral, whereas in other cases it is more appropriate to mark-to-market and adjust for variables such as the tenor, clearing status, and asset class of particular exposures. To do so, regulators should rely on prudential tools that would allow the collection of data from bank counterparties. The SCOOS, for example, is a valuable resource that regulators can use to track the volume of leverage going to different types of NBFIs and the types of financial instruments that NBFIs use to acquire leverage from their bank counterparties.

#### **V. Regulators should understand the important role that leverage plays in supporting financial markets and the broader economy**

To mitigate the risks associated with leverage, alternative asset managers and their bank counterparties use robust risk management practices to ensure that they effectively manage their exposures. These risk management practices support the productive use of leverage, which plays a vital role in contributing to robust financial markets and financing the broader economy. For example, alternative asset managers often rely on leverage to finance hedging positions to manage risk of other exposures. In addition, private credit funds provide diverse and flexible funding to operating companies that is important to the overall growth of the economy. Alternative asset managers use leverage to free up capital that they can invest in businesses of all sizes. Moreover, alternative asset managers are active participants in the primary and secondary markets, using leverage to finance their investment, trading, arbitrage and hedging activities, which cumulatively enhance price discovery and market efficiency. The use of leverage, in a way that is prudently risk managed, helps facilitate these important activities, which, in turn, are key to maintaining market stability and growing the real economy.

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We have responded to specific questions posed in the consultation in the attached Appendix. Our response to each question reflects the same themes outlined above, in particular that risk management is best driven by the

dynamic nature of counterparties and market behavior, not regulator-driven, static, and prescriptive requirements that are bound to become outdated and adversely distort markets.

MFA thanks the FSB for the opportunity to comment on this consultation. We would be happy to discuss our comments in more detail with FSB staff. We also welcome the opportunity to continue to work with the FSB and provide any additional information that may be required. Please do not hesitate to contact Rob Hailey ([rhailey@mfaalts.org](mailto:rhailey@mfaalts.org)), Jeff Himstreet ([jhimstreet@mfaalts.org](mailto:jhimstreet@mfaalts.org)) or the undersigned ([jflores@mfaalts.org](mailto:jflores@mfaalts.org)) should you have any questions.

Respectfully submitted,

Jillien Flores

Executive Vice President and  
Global Head of Governmental Affairs

## Appendix: Responses to Questions

### **Recommendation 1**

- 1. Is the description of the financial stability risks from leverage in NBFI accurate and comprehensive? Are there additional vulnerabilities or risk dimensions related to NBFI leverage that authorities should consider for monitoring purposes?**

The FSB should recognize that different types of market participants use leverage in different ways. The alternative asset management industry has exhibited consistent and modest use of leverage over time, as exhibited in reporting on Form PF submissions in the United States and the UK Financial Conduct Authority hedge fund surveys.<sup>1</sup> With respect to private credit in particular, the Federal Reserve concluded in its 2023 Financial Stability Report that, “the financial stability vulnerabilities posed by private credit funds appear limited. Most private credit funds use little leverage and have low redemption risks, making it unlikely that these funds would amplify market stress through asset sales.”<sup>2</sup>

Regulators should recognize that, for alternative asset managers, leverage is often employed as part of hedging transactions that moderate the overall risk of the fund’s portfolio and thus do not present any of the purported financial stability risks. For example, alternative asset managers commonly invest capital raised from investors in long debt and equity positions and rely on derivatives to hedge against currency or interest rate risks. As a result, the net exposure in the portfolio is far less than the combined gross exposure of all the individual positions. In addition, private credit funds provide diverse and flexible funding to operating companies that is important to the overall growth of the economy. Alternative asset managers use leverage to free up capital that they can invest in businesses of all sizes. Moreover, alternative asset managers are active participants in the primary and secondary markets, using leverage to finance their investment, trading arbitrage and hedging activities, which cumulatively enhance price discovery and market efficiency. The use of leverage, in a way that is prudently risk managed, helps facilitate these important activities, which, in turn, are key to maintaining market stability and growing the real economy.

The FSB recommends that regulators have a framework in place to identify and monitor vulnerabilities related to NBFI leverage and related purported financial stability risks. In the United States, an effective monitoring framework for the alternative asset management industry currently exists. Alternative asset managers provide regulators with information about their leverage, borrowing, and other activities through Form PF. The U.S. Federal Reserve also relies on Form PF and regulatory reporting from bank counterparties to assess financial stability risks posed by the alternative

<sup>1</sup> Financial Conduct Authority, *Hedge Fund Survey* (2015), available at <http://www.fca.org.uk/static/documents/hedge-fund-survey.pdf>.

<sup>2</sup> Federal Reserve, *Financial Stability Report*, 47 (2023), available at <https://www.federalreserve.gov/publications/files/financial-stability-report-20241122.pdf>.

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asset management industry and publishes this assessment in an annual Financial Stability Report. In addition, the U.S. Financial Stability Oversight Council (“**FSOC**”) engages in efforts to monitor risks from the alternative asset management industry that are duplicative of the reporting described above. FSOC maintains a Hedge Fund Working Group (“**HFWG**”) that assesses existing and potential emerging risks to U.S. financial stability from alternative asset managers based on their activities and their interconnections with other market participants. As a result of these existing structures, the United States already has developed an effective monitoring framework. In fact, in the United States, the existing monitoring framework has overlaps that could be streamlined and made more efficient. In particular, it is not clear why FSOC needs to maintain a separate and distinct monitoring function for hedge funds relative to any other type of asset manager while, at the same time, the Federal Reserve has responsibility for monitoring financial stability.

## 2. What are the most effective risk metrics that should be considered by authorities to identify and monitor financial stability risks arising from NBFI leverage?

Regulators should rely on risk metrics that are best suited to the parties and the trading or financing relationship. This could include considering net and adjusted measures of leverage that are currently available to regulators. Gross notional exposure (“**GNE**”), without appropriate netting and adjustments, presents an incomplete view of a firm’s risk. Rather than relying on GNE, regulators should use more comprehensive risk metrics currently available to them, such as those that account for netting and adjustments, to assess risk more accurately.

The reason that GNE does not provide a complete picture of a firm’s exposure is because the same gross exposure amount can have very different risks depending on the characteristics of the position. For example, consider the first-percentile loss for each of the market positions held by the following three firms over a five-day period:

	Firm 1	Firm 2	Firm 3
<b>Exposure at Day 0</b>	\$1 billion notional exposure to the S&P 500	\$1 billion notional exposure to generic 5-year UST	\$500 million notional exposure to generic 5-year UST and \$500 million notional exposure to UST futures contracts
<b>First-Percentile Loss at Day 5</b>	\$88 million	\$16 million	\$3 million

Although each of these positions had the same GNE, the ultimate losses for each exposure varied significantly due to the unique risk profile of the exposures. This example demonstrates that regulators need to consider other measures of leverage, such as those that reflect netting and adjustments, to accurately assess the risk associated with a

firm's market exposure.<sup>3</sup> This will allow regulators to more accurately assess a fund's true market or counterparty exposure. Regulators should also tailor the metrics they rely on to match the risk profiles and strategies of the market participants and the trading or financing relationship.

As an example of this overall point, regulators should not use gross synthetic leverage metrics to assess the risks associated with derivative positions. As stated by the Bank of England, "GNE is not informative about the potential losses and liquidity demands that a fund could face" with respect to synthetic leverage because GNE does not consider the sensitivity of derivatives to different risk factors, offsetting exposures to derivative positions, or the purpose of a derivative exposure to increase or hedge risk.<sup>4</sup> Therefore, to avoid providing regulators with an inaccurate impression of the risks associated with these positions, rather than requiring that bank counterparties report gross synthetic leverage from derivative positions with alternative asset managers, regulators should instead focus on adjusted synthetic leverage which more accurately reflects risk.

Relying on risk metrics that provide a more complete understanding of a market participant's risk profile and that are tailored to the situation will assist regulators in developing policies that appropriately reflect the amount of risk in the NBFIs industry. For example, regulators should consider the following risk measures, described in more detail below: (i) netting; (ii) asset class; (iii) tenor; (iv) margin and collateral; and (v) clearing status. These metrics should only be used, however, as appropriate based on the risk profile of the market participants and any particular trading or financing relationship.

#### **i. Netting**

Considering the offsetting exposures in a portfolio can be a useful metric to assist regulators in understanding a fund's risk profile because offsetting exposures do not increase risk; rather, they help investment funds manage their risk. For example, options that are hedged with the reference asset or other offsetting options, futures hedged with the deliverable reference asset, interest rate swaps hedged with corresponding government bonds, and interest rate derivatives held under the same master netting agreement or at the same clearinghouse should, to the extent there are offsetting cash flows, be recognized in any effort to measure a fund's total exposure. As part of their risk management strategy, some alternative asset managers calculate their exposures using value-at-risk ("VaR") or similar netting metrics under a variety of stress scenarios to understand their true leverage. Alternative asset managers rely on this analysis to determine the amount of margin they need to post with bank counterparties and/or central counterparties ("CCPs"), including any additional capital they may need to post in a stress environment. Relying on risk-adjusted metrics would assist regulators in distinguishing between a fund with relatively high leverage that is prudently risk managed because it

<sup>3</sup> Scott Rofey, *CFTC's Market Risk Advisory Committee Meeting*, at 30:43 (Dec. 10, 2024), available at <https://www.youtube.com/watch?v=zeKMxltbvs>.

<sup>4</sup> Bank of England, *Public Comment on IOSCO Report: Leverage*, 4 (2018), available at <https://www.iosco.org/library/pubdocs/615/pdf/Bank%20of%20England.pdf>.

adequately hedges its risk and a fund with relatively high leverage that may be less prudently risk managed because it does not hedge its exposures.

## ii. Asset class

In addition, various asset classes necessarily exhibit different levels of risk and volatility. An effective risk metric, therefore, should treat each asset class appropriately based on its risk profile. For this reason, the Basel Committee on Banking Supervision capital framework for counterparty credit risk applies different supervisory factors to asset classes based on the risk profile for the type of asset, albeit at a basic level.<sup>5</sup> For example, given the size of the interest rate derivatives market, an investment fund with a high GNE resulting from significant holdings of interest rate derivatives is less likely to pose a risk to the financial system than an investment fund with a similar GNE that holds equity swaps or other more thinly traded asset classes.

## iii. Tenor

An effective risk metric might consider the duration of derivative positions, known as tenor. Derivative positions with longer tenors generally are higher risk. For example, the risk of a \$100 million notional 1-year interest rate swap is significantly less than the risk of a \$100 million notional 30-year interest rate swap. By relying on risk metrics that account for differences in the duration of derivatives, regulators can better understand the true risk profile of an investment fund.

## iv. Margin and collateral

An effective risk metric could also adjust an investment fund's exposure for derivatives positions for which initial and daily variation margin are posted. Posting margin and collateral for derivatives positions reduces risk to counterparties, CCPs and the broader financial system because initial margin accounts for potential future exposure and daily variation margin protects the parties against current exposures.<sup>6</sup> The daily exchange of variation margin ensures that there are no unrealized mark-to-market losses, with many hedge funds having zero net uncollateralized exposures and typically being overcollateralized.

## v. Clearing status

Furthermore, regulators could rely on risk metrics that take into account the clearing status of positions. Positions cleared through a CCP create less risk for the financial system than uncleared transactions. This is because CCPs reduce risk by acting as a counterparty to every trade, performing multilateral netting, requiring members to post initial and variation margin, and providing various safeguards and risk management practices to minimize the impact that the failure of any one clearing member or its customer has on other members.

<sup>5</sup> Basel Committee on Banking Supervision, *Basel Framework* CRE52.72 (Jan. 1, 2023).

<sup>6</sup> Daily variation margin ensures that there are no current unrealized market-to-market losses. Initial margin ensures that in the event of default, the portfolio can be liquidated with the initial margin covering any potential shortfalls that occur during the liquidation process.

In summary, instead of relying on gross risk metrics, regulators should use available risk metrics, such as netting and adjustment metrics, that provide a more accurate understanding of a fund's risk profile and are appropriately tailored to the situation. A one-size-fits-all approach to measuring leverage cannot accurately assess the risk of market participants with such different strategies. This approach would help regulators to better understand the actual risks of investment funds and would better support financial stability by permitting managers to: (i) responsibly deploy leverage when it reduces risk by helping the fund hedge its long positions; and (ii) trade products in large, liquid markets that have higher notional amounts instead of trading products that have lower notional amounts, but are in less liquid markets. This point has been noted by the FSOC, which stated that "[e]valuating risks from the use of leverage by hedge funds requires an analysis of other factors, which could include the nature of investment positions, trading and hedging strategies, financing arrangements, counterparties, margin requirements, and the effects of central clearing."<sup>7</sup>

### **3. What are the most effective metrics for the monitoring of financial stability risks resulting from:**

#### **i. specific market activities, such as trading and investing in repos and derivatives?**

To effectively measure and monitor financial stability risks from market activities such as securities financing transactions ("SFTs") (including repos) and derivatives, regulators should focus on the activities of dealer counterparties and for cleared products, CCPs. In particular, regulators should evaluate the margin and collateral levels that dealers and CCPs require from their alternative asset manager counterparties and the counterparty default rates that dealers and CCPs report.

In addition, regulators should focus their metrics on the activities of dealer counterparties because dealers and similar sell-side entities are accustomed to complying with reporting requirements. This approach would improve the quality of information that regulators receive, and therefore the quality of metrics they develop to assess financial stability risk. By contrast, alternative asset managers and similar buy-side entities are not as experienced with regulatory reporting and typically report more limited information on a delayed basis. Alternative asset managers would need to invest significant time and resources to develop the quality of reporting systems that dealers already have in place.

The SCOOS is an example of a market-driven approach to financial stability risk metrics that collect data from dealers on their SFT and OTC derivatives activities and allows regulators to monitor financial markets in a dynamic way. The SCOOS collects qualitative information on credit terms and conditions in securities financing and OTC derivatives markets, which are important conduits for leverage in the financial system. The survey panel for the SCOOS began by

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<sup>7</sup> Financial Stability Oversight Council, *Update on Review of Asset Management Products and Activities*, 16 (April 18, 2016), available at <https://home.treasury.gov/system/files/261/Financial%20Stability%20Oversight%20Council%20Update%20on%20Review%20of%20Asset%20Management%20Products%20and%20Activities.pdf>.



including 20 dealers and over time has been expanded. These firms account for almost all of the dealer activity in dollar-denominated securities financing and OTC derivatives markets.<sup>8</sup>

**ii. specific types of entities, such as hedge funds, other leveraged investment funds, insurance companies and pension funds?**

Metrics focused on the financial stability risk stemming from alternative asset managers should be based on data that is already reported through existing alternative asset manager disclosures, such as Form PF in the United States and Annex IV in Europe. Alternative asset managers currently report extensive information to the European Systemic Risk Board (“ESRB”) on Annex IV and to the SEC in Form PF. These reports include information on stress tests, portfolio information including collateral, margin and cash reserves, counterparty exposures, the financing sources for alternative asset managers, and detailed analyses of funds’ asset and liability liquidity, including redemption provisions.

**iii. concentration and crowded trading strategies?**

Specific metrics are not needed to measure concentration in the alternative asset management industry because the financial stability risk resulting from concentration is very limited with respect to alternative asset managers. The alternative asset management sector includes many strategies that tend to be less correlated with each other than in broader markets, and the diverse strategies mitigate or diffuse collective risks because the strategies have different underlying risk profiles, assets, and liquidity constraints. In certain circumstances, investors of all sizes trade securities in parallel based on news or economic events, but it would be inappropriate to attribute this correlation specifically to alternative asset managers or investment funds more generally.

**Recommendation 3**

**4. What types of publicly disclosed information (e.g. transaction volumes, outstanding amounts, aggregated regulatory data) are useful for market participants to enhance their liquidity or counterparty credit risk management? Are there trade-offs in publicly disclosing such information and, if so, what would be the most important elements to consider? What is the appropriate publication frequency and level of aggregation of publicly disclosed information?**

Regulators currently disclose valuable market data to market participants. In limited circumstances where regulators determine that public disclosure of data on alternative asset managers’ activities is warranted, MFA encourages regulators to only publish aggregated, anonymized data. MFA advises strongly against any public position disclosure that would compel investment funds to directly or indirectly publicly reveal their otherwise confidential investment positions and trading strategies. Academic research has shown that the public disclosure of otherwise confidential investment positions – even on a limited basis and with long reporting timeframes – impairs investment returns and negatively impacts market quality and efficiency. The potential consequences of such disclosures include: (i)

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<sup>8</sup> Board of Governors of the Federal Reserve System, *Senior Credit Officer Opinion Survey on Dealer Financing Terms*, available at <https://www.federalreserve.gov/data/scoos.htm>.

facilitating copycatting and free-riding; (ii) allowing other market participants to reverse engineer investment theses and trading strategies; (iii) compromising investors' ability to establish and risk manage right-sized positions without having outsized market impact; and (iv) reducing incentives to conduct fundamentally driven research. These adverse consequences, in turn, negatively impact market quality and efficiency by impairing the price discovery process, diminishing market efficiency and liquidity, and undermining the critical role that actively managed investment strategies play in the markets.

Instead, regulators should only publish data on alternative asset managers that is aggregated and anonymized. Example of this include the SCOOS, which we discussed above in our response to Question 3(i), the Federal Reserve's Financial Stability Report ("**Financial Stability Report**"), the CFTC's Commitment of Traders Report, and the SWES. The Financial Stability Report relies on comprehensive data collected through Form PF to evaluate and publish aggregated and anonymized data on leverage in the alternative asset management industry. For example, the November 2024 Financial Stability Report says that recent data from Form PF "indicated that measures of leverage averaged across all hedge funds were at or near the highest level observed since these data became available in 2013."<sup>9</sup> The CFTC's Commitments of Traders Report relies on confidential daily large-trader data that dealers provide to the CFTC, which the CFTC aggregates, anonymizes, and publishes.<sup>10</sup> In addition, the SWES aggregates data from a group of banks and NBFIs to assess how they perform in a stress environment. For example, the SWES revealed that a sudden increase in haircuts or contraction in available repo could significantly impact the positions that alternative asset managers hold in the UST repo market.<sup>11</sup>

These aggregated and anonymized, public disclosures may provide some limited value to bank counterparties assessing their counterparty risk, but the most valuable information available to a bank counterparty is the bilateral information disclosed by the counterparty directly to the bank. The counterparty risk associated with an alternative asset manager that uses leverage varies depending, in part, on the size, complexity, and amount of exposure of the fund. That is why counterparties tailor their disclosure requirements to the unique risks associated with each counterparty. These bilateral disclosures, which are driven by the risk management practice of dealers in evaluating the risk an alternative asset manager poses to its counterparty and to the market, are more useful to market participants than public disclosures.

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<sup>9</sup> Board of Governors of the Federal Reserve System, *Financial Stability Report*, 31 (Nov. 2024), available at <https://www.federalreserve.gov/publications/files/financial-stability-report-20240419.pdf>.

<sup>10</sup> CFTC, *Commitments of Traders*, available at <https://www.cftc.gov/MarketReports/CommitmentsofTraders/index.htm>.

<sup>11</sup> Andrew Bailey, Governor, Bank of England, *Are we underestimating changes in financial markets?* (Feb. 11, 2025), available at <https://www.bankofengland.co.uk/speech/2025/february/andrew-bailey-keynote-speech-university-of-chicago-booth-school-of-business>; Bank of England, *System-wide exploratory scenario exercise final report* (Nov. 29, 2024), available at <https://www.bankofengland.co.uk/financial-stability/boe-system-wide-exploratory-scenario-exercise/boe-swes-exercise-final-report>.

The most effective disclosures for market participants to enhance their liquidity and counterparty credit risk management are those that are tailored to the nature of their counterparty. There is limited value in alternative asset managers, which generally engage in complex transactions with sophisticated institutional investors, publicly disclosing additional information about their activities because they already provide important information to their trading and financing counterparties bilaterally. Public disclosure of data on alternative asset managers' activities also could confuse and mislead the public and may potentially reveal proprietary data that could harm the funds' investors.

In addition, alternative asset managers are required to provide information to regulators through Form PF and Annex IV. Although this information reported to regulators is not made public, regulators are well positioned to use the confidential information to identify and combat risks to the financial system, which in fact is the original purpose of the Form PF and Annex IV.

### **Recommendations 4 and 5**

#### **5. Do Recommendations 4 and 5 sufficiently capture measures that would be used to address the scope of non-bank financial entities under consideration in this report? In what ways may the policy measures proposed in the consultation report need to be adjusted to account for different types of non-bank financial entities?**

The activity-based and entity-based measures described in Recommendations 4 and 5 would not effectively address the purported financial stability risks associated with alternative asset managers' use of leverage.

Following the 2008 financial crisis, regulators implemented requirements such as derivatives clearing, margining, and reporting which bolstered the resiliency of these markets, in which alternative asset managers are active participants. This market-wide solution minimizes the risk that the failure of any individual market participant, including an alternative asset manager, would spread to its counterparties or more broadly to the rest of the financial system. Since 2008, regulators and market participants have strengthened counterparty risk management practices through both regulation and market practice, further reducing the likelihood that counterparty exposures, even in periods of market stress, would have widespread impact on financial markets. For example, quarterly Form PF reports filed by alternative asset managers in the United States show that alternative asset managers overwhelmingly obtain their financing through collateralized arrangements from sophisticated dealer counterparties with robust risk monitoring. In a December 2020 report, the Government Accountability Office concluded that these dealer counterparties could absorb losses associated with exposure to leveraged borrowers, including alternative asset managers, suggesting that interconnectedness between alternative asset managers and dealer counterparties would not pose significant risk to the financial system.<sup>12</sup>

Alternative asset managers actively manage their risk by controlling redemptions and implementing robust risk management practices. Alternative asset managers control the timing and amount of redemptions by investors through contractual arrangements to manage their liquidity risk. By controlling redemptions, alternative asset managers can

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<sup>12</sup> Government Accountability Office, *Financial Stability: Agencies Have Found Leveraged Lending to Significantly Threaten Stability but Remain Cautious Amid Pandemic*, 33-34 (2020).

greatly mitigate fire sale concerns.<sup>13</sup> Form PF reports provide detailed analyses of alternative asset managers' asset and liability liquidity, as well as redemption provisions and counterparty information. Alternative asset managers also manage their market and leverage risk by building redundancy into their risk management processes. For example, firms develop risk guidelines for front-line portfolio managers to ensure that portfolio managers operate within the risk appetite of a particular fund. In addition, both the management of the strategy and the firm's risk management monitor portfolio activities, with appropriate escalation if activities exceed predefined risk tolerances.

Existing regulations and market practices allow alternative asset managers and their dealer counterparties to effectively manage counterparty credit risk. Additional activity-based or entity-based systemic regulation is unnecessary for the alternative asset management industry and could result in unintended consequences for the financial markets. In our response to Question 6 below, we discuss why activity-based measures would not effectively address financial stability risks that leveraged alternative asset managers pose to their counterparties. In our response to Question 10 below, we discuss why entity-based measures, namely leverage limits, would not effectively address financial stability risks that leveraged alternative asset managers pose to their counterparties.

**6. In what circumstances can activity-based measures, such as:**

- i. minimum haircuts in securities financing transactions, including government bond repos,**
- ii. enhanced margin requirements between non-bank financial entities and their derivatives counterparties, or**
- iii. central clearing, be effective in addressing financial stability risks related to NBFIs leverage in core financial markets, including government bond markets? To what extent can these three types of policy measures complement each other?**

Financing counterparties currently rely on haircuts, margin requirements, and central clearing to help them manage their counterparty credit risk. Financing counterparties negotiate these requirements into the terms of their transactions with alternative asset managers. Each of these tools can be effective at reducing risk to individual financing counterparties and to the financial system.

Financing counterparties developed these standard market practices to effectively manage their counterparty risk. Regulators can support the stability and efficiency of financial markets by encouraging these best practices to be adopted across the market. Regulators should not, however, prescribe specific activity-based measures that banks and their counterparties must use to manage their risks. The risks posed by a particular alternative asset manager to a bank counterparty are based on the unique features of the parties and the trading or financing relationship. For example, a transaction with a traditional credit fund, where the risk involved is unlikely to be idiosyncratic, does not merit the same degree of diligence as a fund with a complicated trading strategy. Prudent risk management practices also include providing certain disclosures to bank counterparties. Market participants have mutually determined the disclosures that

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<sup>13</sup> See MFA, *The Role of Private Credit in U.S. Capital Markets*, 10 (2020).

bank counterparties require to effectively manage their risk, which notably does not include position-specific information. Position-specific information is not needed for risk management purposes and disclosing such information could run counter to important commercial objectives because, for example, such information is highly sensitive and disclosing this information to bank counterparties could inadvertently reveal information about confidential proprietary trading and counterparty diversification strategies. Bank counterparties are better positioned than regulators to know what requirements to impose on alternative asset managers to effectively manage their counterparty credit risk.

Haircuts and margin requirements can be effective tools that bank counterparties should consider using, but regulators should not restrict banks' flexibility to choose the appropriate tool and calibrate the requirements to each relationship with a different counterparty. This is especially true when the market identifies new measures for managing counterparty credit risk that may prove to be more effective. Regulators can further mitigate risk through increased mandatory central clearing. In addition, risk management tools, particularly haircuts and margin requirements, come with a cost to market participants that ultimately affects the broader economy. It is important that bank counterparties apply haircuts and margin requirements that are appropriately tailored to the unique risks posed by each counterparty and trading or financing relationship to avoid unnecessary costs and market inefficiencies. For example, see below for a deeper dive on the costs associated with haircuts for the cash-futures basis trade.

### **Cash-Futures Basis Trade**

The cash-futures basis trade is one example of how bank counterparties appropriately tailor their risk management practices to the risk profile of the counterparty and the trading or financing relationship.

The basis trade refers to a position established through the sale of a UST futures contract and the purchase of a UST bond that is deliverable under the futures contract. Many investors—such as mutual funds and pension funds—increasingly rely on UST futures as an efficient way to obtain exposure to USTs in their portfolios while maximizing their allocation to other higher-yielding assets, such as corporate bonds. High demand for UST futures relative to supply leads to a pricing discrepancy, where the futures contract trades at a premium to the underlying bond. This pricing discrepancy—or “basis”—provides an arbitrage opportunity for market participants, such as alternative asset managers, who can sell the future and buy an underlying deliverable cash UST. At the expiry date of the futures contract, the prices converge, making the trade profitable for the seller of the futures contract.

The difference in price between the futures contract and the UST is small. To make the trade economically viable, alternative asset managers often use leverage, buying USTs in the cash market and then funding their purchases with banks by making use of the repurchase agreement (“repo”) market. Bank counterparties require alternative asset managers to post margin on the futures leg of the trade and bank counterparties apply haircuts to collateral posted by alternative asset managers on the repo transaction used to finance the cash leg of the trade.

Regulators in various jurisdictions have proposed implementing minimum haircuts on bilateral uncleared repo trades, which would apply to the repo transactions that finance the cash leg of the basis trade. Regulator-driven minimum haircuts would be inappropriate for the cash-basis trade because they do not consider the alternative asset manager's full position with the bank counterparty. Repo financing is provided under master netting agreements where the bank counterparty recognizes that its alternative asset manager client has a netted package of both a UST future and a cash UST with the bank counterparty. The futures leg of the trade is over-collateralized because the Chicago

Mercantile Exchange (“**CME**”) margins the short futures position as an outright directional position and does not account for the underlying cash UST being held against it. Bank counterparties often apply a “zero haircut” to the repo financing transaction, but this is a misnomer because banks recognize that if they had to close out their counterparty’s full position, they would be able to cover any losses on the repo financing transaction by calling the excess margin posted on the futures leg of the trade.

Banks, therefore, appropriately manage their counterparty risk by applying haircuts and margin requirements in a way that is best suited to the risks posed by the unique features of the basis trade. The Federal Reserve affirmed this in their 2023 Financial Stability Report, which said that concerns about risk in the basis trade are being “mitigated by tighter financing terms applied to hedge funds by dealer counterparties over the past several quarters.”<sup>14</sup> If regulators were to require banks to apply minimum haircuts on basis trades, it would increase the cost to finance basis trades, increase volatility, and reduce liquidity in the UST market, all without meaningfully improving banks’ counterparty risk management.<sup>15</sup>

The market operates effectively to encourage alternative asset managers and dealer counterparties to continue to operate prudent risk management strategies so that they can maintain their trading relationships and avoid undue risk. A more prescriptive, regulatory-driven approach would disrupt this balance, introduce unnecessary friction and reduce efficiency and liquidity in the markets. Regulators should ensure that bank counterparties retain the flexibility they need to implement risk management practices that are best suited to their counterparties and trading and financing relationships. At the same time, all market participants would benefit if prevailing best practices in risk management are consistently followed by banks and their counterparties. Prevailing risk management practices do not require alternative asset managers to share position-specific information with their bank counterparties because doing so could result in potential harm to the alternative asset managers and their clients. Disclosing position-specific information could run counter to important commercial objectives because, for example, such information is highly sensitive and disclosing this information to bank counterparties could inadvertently reveal information about confidential proprietary trading and counterparty diversification strategies.

**7. Are there benefits to dynamic approaches to minimum margin and haircut requirements, e.g., where the requirements change based on changes in concentration or system-wide leverage? If so, what types of indicators capturing concentration or system-wide leverage should the requirements be linked to?**

Dynamic margin requirements protect bank counterparties from risks associated with their counterparties, which include alternative asset managers. Dynamic margin requirements, however, also (i) increase the bank’s

<sup>14</sup> Board of Governors of the Federal Reserve System, *Financial Stability Report* (October 2023), available at <https://www.federalreserve.gov/publications/files/financial-stability-report-20231020.pdf>.

<sup>15</sup> Board of Governors of the Federal Reserve System, *Hedge Fund Treasury Exposures, Repo, and Margining* (Sept. 8, 2023), available at <https://www.federalreserve.gov/econres/notes/feds-notes/hedge-fund-treasury-exposures-repo-and-margining-20230908.html> (“[Most] funds already satisfy the collateral requirement and, in our analysis, do not need additional capital to support existing borrowing.... [Imposing leverage limits] may affect the size and volatility of spreads among related instruments in Treasury cash and derivatives markets, as well as market liquidity conditions in those markets.”).

monitoring costs and (ii) correspondingly increase the counterparty's costs in complying with the margin requirements in the agreement.

If the bank counterparty is required to implement dynamic margin requirements without regard to its counterparty, then the overall increase in costs will often outweigh the corresponding reduction in risk. Dynamic margining can also create liquidity risk for alternative asset managers because the margin requirements can swing significantly and require alternative asset managers to post additional margin without any notice. The pressure that dynamic margining puts on alternative asset managers can increase the risk to the bank counterparty that the alternative asset manager fails.

Bank counterparties would be better served by refraining from implementing dynamic margining measures and using the cost savings to absorb against potential losses. Bank counterparties are best positioned to determine the approach to margin requirements that mitigate their risk of loss based on their counterparty and the type of exposure.

**8. Are there any potential unintended consequences from activity-based measures beyond those identified in the consultation report?**

Yes, as discussed above in our response to Question 6, a prescriptive activities-based approach would limit the flexibility that alternative asset managers and their bank counterparties have to appropriately manage their risk based on the idiosyncratic nature of each counterparty and transaction. Activities-based measures could also increase the cost to finance trades, increase volatility, and reduce liquidity in the market.

**9. For non-centrally cleared securities financing transactions, including government bond repos, what are the merits of margin requirements compared to minimum haircuts?**

Regulator-driven margin requirements and minimum haircuts are both unnecessary to manage risk from non-centrally cleared SFTs. As discussed above in our response to Question 6, the bank counterparties in these transactions are better positioned to determine what information they need to manage their risk from the particular trading or financing relationship.

**10. In what circumstances can entity-based measures, such as:**

- i. **direct, and**
- ii. **indirect leverage limits be effective in addressing financial stability risks related to NBFI leverage in core financial markets?**

Regulators should not prescribe leverage limits that bank counterparties must impose on alternative asset managers. As with our response to Question 6 above, regarding the need for bank counterparties to have the flexibility to apply their own activities-based measures to manage their counterparty credit risk, bank counterparties should also have the authority to establish leverage limits as they see fit to manage their risk based on the specific circumstances of the parties and the trading and financing relationship.



In addition, leverage limits have at times contributed to, or exacerbated, periods of market stress. For example, in recent years, growth in the UST market has outpaced the capacity of the banks, broker-dealers, and proprietary trading firms to make markets and intermediate UST transactions. Although the markets have grown, the relative ability of these firms to absorb net market flows, particularly during periods of increased market stress and volatility, has decreased due, at least in significant part, to regulatory constraints and other limitations on balance sheet and capital capacity allocated to UST market activity.<sup>16</sup>

**11. Are there ways to design and calibrate entity-based measures to increase their risk sensitivity and/or their effectiveness in addressing financial stability risks from NBFIs leverage?**

As discussed above in our response to Question 10, entity-based leverage requirements are inappropriate for alternative asset managers. Regulator-driven leverage requirements cannot be calibrated to address the risks from alternative asset managers' use of leverage as effectively as leverage requirements imposed by bank counterparties.

**12. Are there any potential unintended consequences from entity-based measures beyond those identified in the consultation report?**

Yes, as discussed above in our response to Question 10, entity-based leverage requirements are inappropriate for alternative asset managers and can exacerbate market stress.

**13. To what extent can activity-based and entity-based measures complement each other? What are the main considerations around using these two types of measures in combination?**

As discussed above in our responses to Questions 6 and 10, activities-based and entity-based measures are both inappropriate for alternative asset managers. They would not complement each other. Rather, if authorities were to implement both measures, the combination of the two would have a significant impact on the operation of the SFT and derivative markets and likely reduce liquidity available to market participants.

**Recommendation 6**

**14. How could counterparty credit risk management requirements for leverage providers be enhanced to be more effective in addressing financial stability risks from NBFIs leverage in core financial markets, such as government bond repo markets? In what circumstances can they be most effective?**

MFA agrees with the FSB's objective of enhancing standards to manage counterparty credit risk, but encourages authorities to adopt requirements that are risk-based and permit bank counterparties to manage their credit and

<sup>16</sup> See Group of Thirty Working Group on Treasury Market Liquidity, *U.S. Treasury Markets: Steps Toward Increased Resilience* (2022) ("The root cause of the increasing frequency of episodes of UST market dysfunction under stress is that the aggregate amount of capital allocated to market-making by bank affiliated dealers has not kept pace with the very rapid growth of marketable UST debt outstanding, in part because leverage requirements that were introduced as part of the post-global financial crisis bank regulatory regime have discouraged bank-affiliated dealers from allocating capital to relatively low-risk activities like market-making.")

liquidity risk in a way that is proportional to the risks associated with each counterparty and trading or financing relationship. As important market participants in the capital markets, alternative asset managers should and do apply sound risk management practices, both to minimize risks to their own firm and to the financial markets more broadly. The market encourages prudent risk management to ensure that alternative asset managers and their dealer counterparties maintain their trading and financing relationships and are not exposed to undue risk.

MFA believes that regulator-driven, prescriptive requirements would apply a one-size fits all approach and not permit bank counterparties to customize their margin and collateral requirements to best mitigate their counterparty credit risk. This would create friction in the markets, increasing costs, delaying transaction timing, and increasing the chance that proprietary information would be improperly obtained or disseminated. These issues could discourage parties from engaging in repo and derivative markets, reducing market liquidity. In addition, prescriptive activity-based or entity-based restrictions are bound to become outdated, failing to reflect ever-changing markets and thereby adversely affecting market functionality.

Instead, MFA recommends that regulators permit bank counterparties to preserve the flexibility to deal with counterparty credit risk in a nuanced manner that tailors the requirements to the needs of the individual alternative asset manager and the trading or financing relationship. At the same time, all market participants would benefit if prevailing best practices in risk management are consistently followed by banks and their counterparties.

#### ***Recommendation 7***

##### **15. Would a minimum set of disclosures to be provided by leverage users to leverage providers be beneficial in improving counterparty credit risk management and reducing financial stability risks from NBFIs leverage, including concentration risks? If so, which types of information and what level of granularity should (and should not) be included in this minimum set and why?**

As discussed above in our response to Question 3(ii), alternative asset managers that operate in the United States and Europe are currently subject to a minimum set of regulatory disclosures in Form PF and Annex IV. In these disclosures, alternative asset managers must report extensive information to regulators about systemic risk metrics, including stress tests, collateral, margin and cash reserves, and counterparty exposures. Bank counterparties also require alternative asset managers to provide them with significant information as part of negotiating the terms of a trading or other counterparty relationship. Bank counterparties are better positioned than regulators to know what information they need from their counterparties to manage their counterparty credit risk. Alternative asset managers and dealer counterparties can negotiate the appropriate information to share with each other in a dynamic environment. As markets shift and new or different information becomes relevant to prudent risk management, counterparties can adjust what they share with each other accordingly.

If alternative asset managers were required to provide their bank counterparties with additional disclosures mandated by regulators, however, the disclosures are unlikely to be as dynamic. The disclosures also may not initially provide bank counterparties with the appropriate information they need to manage their counterparty risk. Regulator-

driven disclosure requirements may result in a check-the-box exercise that increases costs on parties while distorting markets and behaviors.

Rather than impose prescriptive disclosure requirements, regulators should instead play a role in establishing principles for bank counterparties to follow when developing their disclosure and risk management practices. For example, prudential authorities may acknowledge and expect that banks should: (i) establish internal standards for the quality and frequency of disclosures; (ii) make risk appetite decisions based on the full range of disclosures provided to the bank; and (iii) condition doing business with the counterparty on the quality of that counterparty's disclosures.<sup>17</sup>

These guiding principles could be particularly important in a competitive market, where competitors can require additional information from nonbank counterparties to manage their risk.<sup>18</sup> By establishing risk management principles based on prevailing best practices, regulators can enhance disclosures and help ensure that all market participants maintain the same high standards for risk management that established bank counterparties currently follow. At the same time, these principles would still preserve flexibility for banks to determine the disclosures that are appropriate for each counterparty and trading or financing relationship. Guiding principles from regulators would be more effective at helping banks assess their risk than regulator-driven minimum disclosure requirements that dictate the specific information that banks require from their counterparties.

Regulators should not, however, dictate the specific disclosures that banks require from their counterparties. As one example, alternative asset managers should not be required to disclose position-specific information to bank counterparties. Prevailing risk management practices do not require alternative asset managers to share position-specific information with their bank counterparties because doing so could result in potential harm to the alternative asset managers and their clients. Market participants have determined that position-specific information is not needed for risk management purposes and that disclosing such information could run counter to important commercial objectives because, for example, such information is highly sensitive and disclosing this information to bank counterparties could inadvertently reveal information about confidential proprietary trading and counterparty diversification strategies. Bank counterparties otherwise are generally well-positioned to require additional information from nonbank counterparties as their own risk management practices dictate.

**16. What are the main impediments that leverage users face in sharing additional or more granular data with their leverage providers? Is there a risk that a minimum recommended set of disclosures may lead leverage users to limit the information they share with their leverage providers to that minimum set?**

As discussed above in our response to Question 15, bank counterparties are in a strong position to negotiate with alternative asset managers for additional information about the alternative asset manager. Banks do not face any significant impediments to receiving data from their counterparties. By negotiating over information for each deal, bank

<sup>17</sup> Rebecca Jackson, Executive Director, Bank of England, *Prime brokerage* (Jan. 28, 2025), <https://www.bankofengland.co.uk/speech/2025/january/rebecca-jackson-speech-at-uk-finance-prime-brokerage>.

<sup>18</sup> *Id.*

counterparties can tailor their information requests to the specific risks associated with the counterparty and the trading or financing relationship.

This approach is more efficient and more effective at obtaining necessary data than mandating a minimum set of disclosures. If authorities require alternative asset managers to provide specific information to bank counterparties for every deal, it would often result in wasted resources as the alternative asset managers incur costs to provide their counterparties with information that is not necessary for that transaction. In addition, if alternative asset managers are required to provide certain information to counterparties, they may be less willing to negotiate with bank counterparties to provide additional information that is more applicable to assessing the counterparty credit risk of that transaction.

**17. Should such a minimum set of disclosures rely on harmonised data and metrics to ensure transparency and efficiency in the use of such information for risk management purposes? Do respondents agree that such a minimum set of disclosures should be based on the list of principles outlined in the consultation report? If not, which principles should be added, deleted or amended?**

Regulators should not prescribe minimum disclosures that alternative asset managers must provide to dealer counterparties. As discussed above in our response to Question 15, the disclosures that bank counterparties require to assess and manage their counterparty credit and liquidity risk are unique to each alternative asset manager and each trading relationship. Different types of trading relationships and different alternative asset managers may warrant different disclosures from the alternative asset manager. Regulators can play an important role in establishing uniform disclosure principles for bank counterparties to follow, but regulators should not go further and prescribe mandatory disclosure requirements because it could restrict the flexibility that bank counterparties currently have to negotiate for the information that they need from alternative asset managers to manage their risk.

**18. Should leverage users be required or expected to provide enhanced disclosures (beyond that provided in normal market conditions) to their leverage providers during times of stress?**

No, as discussed above in our response to Question 15, authorities should not require alternative asset managers to provide particular disclosures to counterparties at any time because bank counterparties can more effectively obtain the unique information they need for each transaction by negotiating with alternative asset managers.

**19. Should authorities design a minimum set of harmonised disclosures and guidelines on its application, or should they convene a cross-industry working group to do so? How do respondents believe such a standard should be incorporated into market practice? Through regulation, supervisory guidance, and/or via a Code of Conduct or similar approach?**

MFA does not believe that authorities should set minimum disclosure standards for market participants. As discussed above in our response to Question 3(ii), alternative asset managers that operate in the United States and Europe are already subject to a minimum set of regulatory disclosures in Form PF and Annex IV.

Rather than requiring additional regulatory or public disclosures from alternative asset managers, regulators should instead focus their attention on harmonizing and improving the usefulness and efficiency of the regulatory

disclosures required in Form PF and Annex IV. Regulators should seek to ensure that data reported from investment funds is harmonized across jurisdictions so that regulators can make an “apples to apples” comparison of fund data. Inconsistent data sets in the Form PF and Annex IV data (for example, inconsistent derivatives trade reporting) severely limits the usefulness of the data. Without accurate data from alternative asset managers that is comparable across jurisdictions, regulators cannot fully understand the strategies, investments, size, and risks of investment funds. In addition to any harmonization efforts, and more broadly, regulators should consider whether the data required to be reported is useful for its intended purposes or, alternatively, whether changes are warranted.

In addition to ensuring that disclosures are harmonized, as noted above, prudential regulators should also focus on enhancing their coordination across jurisdictions. The most effective way to identify and assess risks to the financial system is to monitor emerging risks at bank counterparties, including multi-jurisdictional examinations of key bank business lines.<sup>19</sup> If prudential regulators work together across jurisdictions – for example, the Bank of England and the Federal Reserve collaborating on the SWES and the Financial Stability Report – they will be better positioned to understand and address financial risks posed to bank counterparties by NBFI leverage.

### **Recommendation 8**

#### **20. Are there areas where the principle of “same risk, same regulatory treatment” should be more consistently applied? Are there circumstances in which the principle should not apply or should not apply comprehensively?**

Alternative asset managers should not be subject to the same regulatory treatment as banks because alternative asset managers have wholly inapposite and distinct risk profile than banks that poses significantly less risk to financial stability. This point is illustrated by the fact that over 1,000 alternative asset managers close every year,<sup>20</sup> all without raising systemic concerns. According to a recent analysis by the Board of Governors of the U.S. Federal Reserve System, the failure of five hedge funds with the largest counterparty exposures to the U.S. global systemically important banks would result in losses of only between 1.0 and 1.2 percent of those banks’ risk-weighted assets.<sup>21</sup> This analysis demonstrates that even the largest alternative asset managers can fail without posing sizeable risk to their bank counterparties or the broader financial system. In contrast, the failure of a few significant banking institutions can lead to disruption and panic in the financial system, as reflected in March 2023 with the failures of Credit Suisse, Silicon Valley Bank, Signature Bank, and First Republic Bank.

<sup>19</sup> Andrew Bailey, Governor, Bank of England, *Are we underestimating changes in financial markets?* (Feb. 11, 2025), available at <https://www.bankofengland.co.uk/speech/2025/february/andrew-bailey-keynote-speech-university-of-chicago-booth-school-of-business>.

<sup>20</sup> For context, as of December 6, 2024, over 50,000 alternative asset managers report to the SEC on Form PF. See Securities and Exchange Commission, Division of Investment Management Analytics Office, *Private Fund Statistics* (2024), available at <https://www.sec.gov/files/investment/private-funds-statistics-2024-q2.pdf>.

<sup>21</sup> See *Dodd-Frank Act Stress Test Publications*, FED. RSVE. (July 17, 2024), available at <https://www.federalreserve.gov/publications/June-2024-Exploratory-Analysis-of-Risks-to-the-BankingSystem.htm>.

Banks are highly leveraged institutions that engage in maturity transformation and are critical to the functioning of the payments system. Alternative asset managers, however, are generally less leveraged and do not deal with the same issues of liquidity mismatch because investors in alternative asset managers have contractually agreed to lock up their investment and, thus, have no ability to withdraw funds on demand. As one example, private credit does not present the same risks as banks because private credit arrangements tend to involve the use of limited leverage and generally rely on long-term funding, as compared to the high leverage and short-term funding used by banks. In contrast, a bank is vulnerable to runs because it is unable to halt depositor withdrawals.

During times of stress, for a bank to meet the short-term liquidity demands of its depositors, the bank generally would need to sell long-term assets which can lead to significant losses for the bank. This scenario can create significant risk to the broader financial system and require government intervention. In contrast, alternative asset managers contractually limit investor withdrawals to prevent runs on the fund and to support investments in long-term assets and through market cycles. Alternative asset managers are also less leveraged than banks and hold more liquid assets, reducing their liquidity risk. For example, data from Form PF shows that alternative asset managers do not have the same kind of liquidity mismatch that banks have. In addition, a staff paper published by the SEC in May 2017 noted that most hedge funds have a “negative liquidity mismatch,” meaning that those funds hold relatively liquid assets compared to the combined liquidity of their liabilities plus equity.<sup>22</sup> Further reinforcing this view, the European Securities and Markets Authority published a risk analysis of alternative asset manager leverage in the European Union in January 2024, stating that “[o]n average [hedge funds] report managing assets that can be liquidated in a short time horizon.”<sup>23</sup> Lastly, alternative asset managers do not benefit from deposit insurance or other government intervention. Accordingly, alternative asset managers, unlike banks, are incentivized to limit their leverage to protect investors and, if an alternative asset manager were to fail, the government would not be responsible for bailing it out.

In light of all of the above, alternative asset managers should not be subject to the same regulatory requirements as banks. Instead, regulators should focus on risk management practices that reflect the unique characteristics of alternative asset managers, their trading and financing strategies, and the benefits alternative asset managers bring to markets. Applying one-size-fits-all regulation to banks and NBFIs, including alternative asset managers, would lead to sub-optimal policies that adversely distort the financial markets.

\* \* \*

<sup>22</sup> See George O. Aragon & A. Tolga Ergun & Mila Getmansky & Giulio Girardi, *Hedge Fund Liquidity Management*, SEC 17 (May 2017), available at [https://www.sec.gov/files/dera\\_hf-liquidity-management.pdf](https://www.sec.gov/files/dera_hf-liquidity-management.pdf).

<sup>23</sup> See Jean Baptiste Haguin, *Assessing the Risks Posed by Leveraged AIFs in the EU*, EUROPEAN SEC. AND MKTS. AUTH. 7-9 (Jan. 30, 2024), available at [https://www.esma.europa.eu/sites/default/files/2024-01/ESMA60-1389274163-2572\\_TRV\\_article\\_-\\_Assessing\\_risks\\_posed\\_by\\_leveraged\\_AIFs\\_in\\_the\\_EU.pdf](https://www.esma.europa.eu/sites/default/files/2024-01/ESMA60-1389274163-2572_TRV_article_-_Assessing_risks_posed_by_leveraged_AIFs_in_the_EU.pdf).