Leverage in Non-Bank Financial Intermediation: Consultation report

Response to Consultation

International Capital Market Association (ICMA)

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?**

We propose that it would be more prudent to consider any financial stability risks caused by leverage specifically from the impact the risks may cause on the core markets and crucial systemically important institutions that are most critical to financial stability rather than applying broad measures across the entire NBFI sector.

The NBFI sector is very heterogenous in the nature of the entities and activities that it captures, and a "one-size fits all" approach would not be effective in identifying and mitigating any potential systemic risks stemming from leverage within the large NBFI sector. It is important to differentiate between the different types of NBFIs and how the different NBFI entities and NBFI activities pose considerably different risks.

Regarding the first channel of risk, the counterparty credit risk channel, it must be noted that much work has been done already with central clearing and margining of non-cleared trades for the whole financial sector, including the NBFI sector. Further work was also conducted in recent years following stress events, including enhancements to banks' counterparty credit risk management through recently finalised BCBS Guidelines on Counterparty Credit Risk

Management. The FSB should prioritise consistent implementation of the standards rather than any enhancements.

In relation to the second channel of risk, namely position liquidation channel, this often arises as a result of the regulations relating to the counterparty credit risk channel which can require margining and can be limited in terms of eligible collateral. The FSB, BCBS, CPMI, and IOSCO have conducted extensive work on this topic over recent years, with a focus on addressing transparency and responsiveness of margin requirements in cleared and uncleared markets. Further enhancements would be best addressed by widening the scope of eligible collateral that is permitted and for this to be supported by margining rules.

The repo market plays an important role in providing financing to entities to manage liquidity risk in times of stress which is critical in ensuring that counterparty credit risk does not increase Any effort by authorities to try to curb this by introducing inefficiencies in the repo markets is likely to negatively impact entities' ability to manage liquidity risk which can lead to an increase in counterparty credit risk and therefore systemic risk.

In the regulated fund space, particularly in the open-ended fund (OEF) sector, there are no excessive leverage concerns, which is recognised at both global (IOSCO) and EU levels. At the global level, IOSCO concluded that "OEFs do not have large aggregate exposures through

derivatives positions, and consequently are not leveraged by any meaningful impact". At the EU level, UCITS funds have to comply with a leverage cap of 100% and a borrowing cap of 10%.

AIFMs have to demonstrate that the leverage limits for each AIF they manage are reasonable and that they comply with those limits at all times. The total amount of leverage employed is reported to the supervisors (with enhanced reporting obligations for leverage exceeding 300%) and also disclosed to investors. Article 25 of the AIFMD grants the competent authorities the ability to impose leverage limits, or other AIF management restrictions, to contain any build-up of systemic risk attributed to leverage. This is a power which has successfully been deployed by the Central Bank of Ireland, in relation to Irish domiciled real estate funds in November 2022, and more recently in April 2024 on GBP LDI funds in coordination with Luxembourg's CSSF.

ESMA also conducts liquidity stress testing guidelines which require managers to ensure they are prepared to meet redemptions and liquidity demands from margin calls. ESMA has recently assessed risks posed by leveraged AIFs in the EU and has concluded that NCAs have the right tools to take an accurate view of risks in their jurisdiction.

Leverage can be an important tool for investors to hedge both market and liquidity risks. Its impact is heavily dependent on how it is used (hedging of risk vs taking risk exposure) and the type of NBFI entity. As described above, in the highly regulated OEFs space, the existing leverage caps and reporting obligations contain any possible source of systemic leverage risk.

The Consultation Report refers specifically to the risk hedge funds pose as they may "often employ substantial leverage to amplify returns, which can lead to rapid deleveraging during market stress, causing significant price movements and affecting liquidity in the underlying assets". It is important to note the growing important role of hedge funds as liquidity providers particularly in the bond market rate space. Furthermore, hedge funds are not a homogenous investor class and are quite diverse in terms of strategies and investment objectives. The relative value nature of many strategies means that they are often agnostic to directional trends which can add a helpful countercyclical element to the market. Furthermore, some of the more algo-driven, arbitrage-based trading strategies help to maintain market efficiency while also generating liquidity.

The role of hedge funds is recognised in a September 2024 ECB blog post "Hedge funds: good or bad for market functioning?" where the ECB highlights concerns that the employment of leverage by hedge funds could raise risks of amplification in the case of market volatility, but they currently find no evidence to support this. Using repo data as a means to identify hedge fund activity (noting that hedge funds use the repo market extensively to finance both long and short bond exposures), the ECB observes an inverse relationship between hedge fund leverage and underlying market volatility.

Also noted by the ECB, hedge funds are reliant on banks' balance sheets to support their investment strategies, particularly through the provision of repo liquidity. Accordingly, the ability for such funds to acquire leverage is contained by already strict capital rules imposed on banks.

The Consultation Report also outlines concerns around leverage users having multiple brokers which could result in excessive or hidden leverage. As was seen during the GFC, concentrating relationships with a single broker exposes leverage users to the risks associated in case the prime broker fails – 40% of Lehman Brothers' clients that used it as their sole prime broker were liquidated following its bankruptcy, compared to only 4% of those with multiple prime brokers. Diversifying prime broker relationships is thus a critical mitigation tool and we would therefore strongly advise against any measures that would concentrate the number of prime brokers leverage users could use.

From the examples provided in the consultation report, particularly Archegos, the issues have not stemmed from any over leveraged NBFIs, but the knock-on consequences for critical institutions like banks, in this case Credit Suisse. Ultimately, any leverage-related regulatory intervention measures which are identified on financial stability grounds, must avoid

outweighing the benefits that leverage facilitates in the markets and the real economy in terms of investment, trading and hedging risk.

Thus, to address potential sources of systemic leverage, which is already well contained within the highly regulated NBFI sector, we consider that the priority focus should be on developing the effective monitoring and supervision of the wider NBFI universe through market

surveillance, and cooperation, by way of system-wide, cross-border, systemic counterparty risk monitoring (to be conducted jointly by authorities, i.e. market authorities and banking

supervisors), leveraging existing data as a priority to avoid any additional burden.

Moreover, we believe that alongside a consideration of the risks presented by NBFI leverage, the FSB and national authorities should recognise the role of the banking prudential framework as a corollary to risks in certain markets. In some cases, banking regulation has had inadvertent consequences on market functioning, by making it more difficult for banks to act. For example, the Federal reserve took emergency action to disapply the supplementary leverage ratio from US treasuries, as it was preventing banks from intermediating in the market during the "dash for cash" episode in March/April 2020. The FSB should reconsider measures that are inadvertently making it more difficult for banks to provide liquidity, with a view to optimising financial stability.

The Bank of England System-Wide Exploratory Scenario exercise is a good example of a market-wide assessment to understand risks to and from NBFIs, and the behaviour of NBFIs and banks in stress, as well as how their behaviours and market dynamics can amplify shocks and pose any potential risks to financial stability. In response to Q3, we describe some considerations for the most appropriate calibration of a system-wide assessment.

Ultimately, it must be noted the risk of these proposed measures of likely introducing friction and inefficiencies, and how they could hinder the NBFI sector to support growth of its local economies and lead to a contraction of investments.

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?**

As highlighted in response to Q1, it is firstly important to acknowledge the different positive use cases for leverage and how it is actually used in the NBFI sector in certain scenarios to mitigate financial stability risks. For instance, counterparties may choose to increase leverage, through repo financing, to meet margin calls, in order to reduce counterparty credit risk.

Out of the four proposed risk metrics (leverage metrics, collateralisation, sensitivity to market risk, concentration risk), we consider leverage metrics to be the most appropriate measure to identify and monitor financial stability risks arising from NBFI leverage.

From an international perspective, leverage metrics can already be considered from a cross-border perspective. At the EU level, ESMA regularly assesses the Leverage Risk embedded in the activities of EU AIFs and discloses this information in its periodic risk reports.

Generally, there is no specific leverage threshold that triggers a potential financial stability risk.

It is dependent on what leverage is being used for (investment or hedging purposes) and whether it has the ability to negatively impact a core market, in which case targeted tools should be deployed. The failure of Archegos is a prime example as its default was significant because of its impact on a specific global systemically important financial institution (Credit Suisse), not because Archegos itself had any systemic significance as a sole financial sector entity.

We consider that the most important starting point is for authorities to focus on their use of all the existing reporting requirements which are already extensive (e.g. G20 Derivative Reporting Rules (e.g. EMIR reporting, MAS, ASIC, MiFID) and SFT Rules (SFTR, new OFR rules being implemented in the US) across instrument types), as well as to reduce barriers to data sharing both across and within jurisdictions.

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

We consider the starting point for the most effective monitoring of financial stability risks should be the prioritisation of the effective use of data through the existing reporting requirements, such as the derivatives and SFTs reporting requirements, but also margin transparency and the extension of types of collateral accepted for cleared and uncleared derivatives. Regulatory monitoring of financial stability risks at the macro-level is an important complement to the due diligence, monitoring and risk management conducted by individual financial institutions. As highlighted previously, the BoE SWES exercise is a good example of system wide monitoring, and we would consider a system wide solution to be the most appropriate tool to monitor financial stability risks resulting from the different variants listed in the question. Unlike the stress-tests that central banks and regulatory authorities conduct on an annual basis to assess the resilience of each individual firm, the system wide assessment includes a much broader range of market participants in order to understand the interactions between the different types of financial institutions and the potential amplification of shocks. This facilitates the identification of any risks to and from NBFIs and any system-wide vulnerabilities which could impact financial stability. To ensure the effectiveness of a system-wide exercise, we advise on certain conditions that should be met to ensure its effectiveness:

- System-wide tests should have a well-defined objective, focusing on how all market participants affect a specific market under a particular scenario.
- These tests should serve as information-gathering tools, not as a means to establish macroprudential policies for non-banks or to set prescriptive rules for individual firms (e.g. liquidity ratios or prudential requirements for banks).
- Supervisors should not make assumptions about market participant behaviour.
- Responses to scenarios should be based on participants' real-world experience, rather than hypothetical simulations created by supervisory authorities.
- It's important to acknowledge that each participant's behaviour and options will be influenced by their counterparties' decisions and reactions, as well as policymaking and the regulatory framework they operate under. Understanding these interdependencies is crucial to make any accurate assessments.
- It should be proportionate and have a defined time frame. Given the data and resource-intensive nature of these tests for firms, they should not be conducted any more frequently than on a 5-year basis.
- Given the global nature of financial markets, jurisdictions should coordinate their assessments to help identify and mitigate any potential cross-border system risks. This coordination is also important in order to avoid excessive regulatory burden on financial market participants.

(ii) specific types of entities, such as hedge funds, other leveraged investment funds, insurance companies and pension funds

(iii) concentration and crowded trading strategies

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?**

We do not consider that enhancing public disclosures would support market participants in enhancing their liquidity or counterparty credit risk management. Transparency can be beneficial in some circumstances, but there are trade-offs to take into consideration, particularly in the case of public disclosures where it could reveal positions which could be detrimental to some business interests.

From a fiduciary duty perspective, financial entities cannot be forced to make public any information which may harm their clients' interests. From a risk management perspective, exposing positions of liquidity providers could also harm liquidity provision and pricing. Public disclosures also risk sending the wrong signal to the market and triggering herd behaviour of fire sales.

There are already extensive robust pre-and post-trade reporting requirements and public disclosures in most jurisdictions. Authorities should prioritise assessing the effectiveness of the information sharing between the jurisdictions and simplify reporting procedures where possible. The priority focus should be on international harmonisation of existing disclosures, especially in the already highly regulated markets of the US, EU and UK.

Recommendation 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?**

   Recommendations 4 and 5 help to emphasise the importance of prudential and market regulators having a sufficient level of market visibility in order to identify potential build ups of leverage-related risks that could threaten financial stability before introducing any new policy interventions, while also highlighting the inadequacies of activity-based measures. As

   explained in the response to Question 6, regulatory frameworks already exist, or are still being implemented, that are designed to limit the amount of leverage that can be provided to non-bank financial entities. It is not clear how introducing the proposed additional activity-based measures, even if calibrated at the entity level, would achieve the stated objective of containing leverage-related risks to financial stability. On the contrary, the proposed activity-based recommendations appear to pose a greater threat to broader market functioning and stability.

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 NBFI leverage in core financial markets, including government bond markets? To what extent can these three types of policy measures complement each other?**

   ICMA does not support the introduction of activity-based measures as outlined in

   Recommendation 5, either in isolation or in combination. None of these proposed measures directly or conclusively address the particular risks that the FSB identifies (i.e. containing and mitigating NBFI leverage that may create risks to financial stability) and instead introduce new risks and market inefficiencies that could undermine market stability.

   (i) Minimum haircuts in securities financing transactions

   ICMA does not support the introduction of minimum haircuts for securities financing transactions for a number of reasons.

   Firstly, it is important to recognise that a capital-based regulatory framework already exists that effectively contains the ability of banks to provide leverage to non-banks. This includes the application of capital risk weightings that are calibrated for both the counterparty and the collateral, both in the standardised approach (SA) and banks' internal models (IM).

   Furthermore, the introduction of the Output Floor (OF) will effectively increase the risk weightings currently applied under IMs. If the FSB has reason to believe that the current regulatory framework, including measures still to be implemented, does not serve its purpose, then it should review the existing calibration rather than introducing additional layers of regulation.

   Secondly, a minimum haircut framework would suggest that all non-bank counterparties are alike. As highlighted elsewhere in this response, NBFIs cannot be grouped together and assessed as a homogenous entity. In reality, NBFIs have very different risk and leverage profiles, and use SFTs for a variety of purposes. Thus, a one-size-fits-all solution would not be appropriate. For a minimum haircut framework to even begin to make sense it would need to be calibrated to account for the specific counterparty risk, which is essentially what the existing regulatory risk capital framework seeks to do.

Thirdly, while haircuts are intended to manage the liquidity risk of the underlying securities (i.e. liquidation risks in the event of default), they have a direct impact on counterparty credit risk. In the case of applying minimum haircuts, this could be distortive. Specifically, an NBFI of higher credit quality than a counterparty bank would be increasing its credit risk to the bank as a result of being charged a haircut. This would increase overall credit risk in the system, counter to the FSB's explicit objectives.

Fourthly, applying minimum haircuts to individual trades does not support the objective of containing overall counterparty leverage. In determining the haircut policy for different SFT transactions with various counterparties, banks make their assessments based on the total aggregate exposure to the counterparty and the cost of capital associated with doing business, and not purely at the individual transaction level. For example, a prime broker may hold significant assets in custody for a client compared to the amount of leverage being provided. In this instance it is not clear, from an overall leverage perspective, what would be achieved by applying a minimum haircut to an individual repo transaction, other than making the trade, in itself, more expensive for the client.

Fifthly, as highlighted in some of the previous points, mandatory minimum haircuts would simply make the cost of transacting SFTs more expensive for non-banks, regardless of their risk or leverage profile, or their motivation for participating in the market. Increasing minimum haircuts for SFTs, will create additional costs and frictions in normal market conditions, that would become even more pronounced in times of heightened volatility or market stress. SFT markets, particularly the repo market, are a source of market stability, facilitating short-term liquidity management and collateral transformation. Adding costs and frictions to the market, particularly in times of heightened volatility or market stress, would seem to be

counterproductive to the objective of maintaining financial stability, and could even exacerbate fire-sales or 'dash-for-cash' scenarios, as market participants struggle to meet increasing margin calls. Which raises the question of whether a countercyclical approach to SFT haircuts would make more sense from a market stability perspective (i.e. maximum haircuts).

Finally, and related to the additional cost to transacting SFTs as a result of minimum haircuts, consideration also needs to be given to the impact on the underlying market, not least core government bond markets. A more expensive and less liquid repo market, with fewer participants, will have a knock-on impact in the outright market, widening bid-ask spreads in the secondary market and new issuance premium in the primary market. Accordingly, the seemingly limited benefits of minimum haircuts also need to be assessed against the wider macroeconomic impacts of raising sovereign borrowing costs, as well as any unintended consequences for financial stability.

It is also important to note that the FSB's Minimum Haircut Framework, which is referenced in the report, has not been implemented in any of the large financial market jurisdictions given in part due to the concerns highlighted above, combined with concerns about the efficacy of the framework itself.

(ii) Enhanced margin requirements between non-bank financial entities and their derivatives counterparties

ICMA would like to point out that there is already in existence a robust global regulatory framework for both cleared and non-cleared derivatives transactions which was implemented by the G20 following the 2008 global financial crisis. A number of improvements to the framework have already been identified, as highlighted in the recently published reports from the BCBS, CPMI, and IOSCO, not least with respect to enhanced transparency of CCP margining models.

However, ICMA is keen to point out that any additional margin requirements related to cleared or non-cleared derivatives transactions need to be balanced against the increased risk of procyclicality. As has been observed in a number of instances, in times of heightened volatility variation margin requirements can increase significantly and quickly, often intraday, which increases reliance on an accessible and liquid repo market as well as triggering sales of (usually higher quality) assets, which are not necessarily leveraged holdings. This can undermine market stability, increasing the risk of a financial crisis.

Moreover, as correctly alluded to in the consultation report, increasing the cost of using derivatives can be a deterrent to hedging and the smooth functioning of risk transfer, thereby increasing systemic risk.

As a further consideration, intended to reduce potential pro-cyclical risks of variation margin calls on centrally-cleared markets, we suggest to extend eligible collateral to HQLA, in particular government bonds.

Regulators should thus amend rules on collateral so that they: i) take a holistic, and systemic, approach to the regulation of collateral, and of activities requiring collateral; ii) are consistent across different types of activity, and across different types of market participants; and iii) ensure that market participants can pool collateral. One example would be to allow central counterparties to diversify where they can hold collateral rather than restrict them to posting collateral with central securities depositories.

Finally, ICMA would emphasise the importance of maintaining robust processes to determine which derivatives products are subject to central clearing mandates to ensure that only appropriately liquid products are mandated for clearing. This should not be expanded arbitrarily to products that are not suitable for clearing.

(iii) Central clearing of securities financing transactions

ICMA is fully supportive of removing regulatory barriers to non-bank access to central clearing for outright and repo transactions in appropriately liquid cash securities, such a government bonds. Central clearing provides several potential benefits in the context of SFTs, including increased settlement efficiency, and improved access to market liquidity. However, ICMA opposes the notion of mandating central clearing for cash securities, noting that the decision to clear should be based on commercial considerations and sound risk management without undue constraints. There are several reasons why ICMA considers the recommendation of mandating central clearing for SFTs to be misguided and risky.

Firstly, it is not entirely clear whether increasing clearing for SFTs would help to constrain leverage. As noted in the consultation report, different models exist to facilitate non-bank access to a CCP. In some models, the sponsoring or agent bank posts the initial margin, which would defeat the main argument underlying the recommendation. Also, again as recognised in the consultation report, cross-product margining arrangements provided by many CCPs, which requires margin against a net exposure, could actually increase the availability of leverage to some entities. For example, the much-reported basis trades popular with certain investor types (which involve both a bond futures and repo position) could be more efficiently (i.e. cheaply) margined if the repo is centrally cleared, compared to it being transacted bilaterally.

Secondly, and very importantly, mandating central clearing for SFTs would introduce

procyclicality risks to the market. As already highlighted, the repo market in particular is an importance source of market stability, facilitating short term liquidity and collateral

transformation. Financial institutions (bank and non-bank) rely on the repo market in order to meet margin calls against their derivatives exposures, which are often hedges. By subjecting repo positions to the risk of significant spikes in variation margin in times of heightened volatility, compared to bilateral repo arrangements, would require even more collateral being required to raise cash to meet margin calls more broadly. This is particularly pertinent in the case of non-bank entities that are predominantly one-directional in terms of repo activity (i.e. lending securities to raise cash), such as pension funds. This would heighten the probability of margin calls being missed, so increasing counterparty credit risk, while diminishing the repo-able value of institutions' high quality liquid assets, thereby increasing market risk.

Thirdly, it is important to recognise the important role that the repo market plays in maturity transformation, allowing financial institutions to secure term funding against their assets.

Centrally clearing term repo trades, without the potential for margin netting, can be

prohibitively expensive due to the high levels and associated uncertainty of variation margin. This creates a natural bias to very short-dated repo transactions when centrally cleared, which can be observed, for instance, in the US Treasury repo market. Mandating central clearing for SFTs would severely restrict the ability of many non-banks to access term funding, creating a systemic reliance on very short-dated repo financing. Such a lack of diversity in financing tenors would be an additional risk to financial stability, particularly in the case of short-term funding shocks.

Fourthly, and also associated with the relative cost of transacting cleared SFTs compared to bilaterally, this would create a potential barrier to accessing the repo market. It is often purported that CCPs create more balance sheet netting opportunities for banks, which should help support more intermediation and deeper liquidity. However, recent studies reveal that on average the benefits of uniform clearing would be relatively modest and largely limited to very short-dated repo. What receives less attention is the fact that increasing banks' exposures to CCPs would also have impacts with respect to liquidity, risk weighted capital, and single counterparty credit limits. In other words, the Leverage Ratio is not the only limiting constraint on banks' balance sheets.

For many non-banks, the cost of clearing SFTs will be prohibitively expensive. As with minimum haircuts for bilateral transactions, consideration needs to be given to the impact on pricing, liquidity, intermediation, and investor diversification in the underlying market, and the wider impacts on government borrowing costs as well as financial stability.

While some jurisdictions are beginning to explore the possibility of mandating central clearing for government bond markets, many will share the concerns we have outlined and will most likely wait to assess the impacts and lessons learned of its projected implementation in the US. ICMA would therefore, as a minimum, suggest waiting for the full effect of the US mandate to be realised and digested before recommending broad adoption.

For the reasons outlined above, ICMA cannot endorse any of the proposed activity-based measures. In isolation, each would create more risks than they seek to address. In combination, these risks would only be compounded.

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?

As discussed in the response to Question 6, dynamic approaches to minimum margin and haircut requirements have the potential to increase the risk of procyclicality in instances of heightened market volatility or stress. In other words, these could act as accelerators for market volatility and so feed financial instability. Increased volatility should be a natural incentive to de-lever, without the additional stress caused by increasing margin requirements further.

In the case of SFTs, it is also important to note that the application of dynamic haircuts or margining would undermine the integrity of the market. Market participants use the repo market for certainty of funding. If they cannot predict with some degree of certainty the cost of borrowing over their required funding horizon, this compromises the basic premise of a functioning market, while simultaneously adding more risk into the system.

Some ICMA members note that where dynamic adjustments exist elsewhere, such as banking regulation, they work in a countercyclical way (e.g. the Countercyclical Capital Buffer). A suggestion for consideration is that a similar approach be taken to any minimum margin or haircut requirements.

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

The consultation report has overlooked many of the unintended consequences that are associated with the proposed activity-based recommendations, and that have been described in the response to Question 6. These can be summarised as:

- Creating additional costs, frictions, and barriers to entry to the repo market, which is a key source of financial stability.
- Feeding procyclicality risks in times of heightened market volatility or stress, particularly with respect to counterparty credit risk and market risk.
- Not addressing leverage and in some cases actually facilitating leverage provision.
- Disincentivising hedging and restricting efficient risk transfer.
- Reducing the availability of term funding (beyond very short-dated repo).
- Detrimentally impacting pricing, liquidity, and investor diversification in core bond markets (with macroeconomic knock-on effects from raising the cost of government borrowing).

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

In the case of non-cleared SFTs, margin requirements and haircuts are not directly comparable.

Margin requirements are generally applied at the entity level based on its overall portfolio of exposures. This could include non-cleared derivatives, repos and reverse repos, as well as prime brokerage financing, among other exposures. This allows banks to make more accurate risk assessments based on a range of criteria, including factors such as aggregate leverage or co-correlation risks.

Haircuts, however, are applied at the individual transaction level in the case of SFTs.

Theoretically, haircuts also serve a different purpose. Since the collateral underlying the transaction is intended to mitigate against counterparty credit risk, the haircut is a mitigant against market liquidity risk (i.e. the expected price slippage in liquidating the collateral in the event of default).

In reality, depending on banks' risk management models, haircuts can be calibrated both on counterparty credit risk as well as the underlying collateral, but also as a means to manage their capital risk weightings (i.e. to reduce RWAs). As explained in the response to Question 6, they are not a very effective tool for containing counterparty leverage, and imposing needlessly high haircuts would only be market-distortive, with the unintended consequences for pricing, liquidity, and access that brings.

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?

It is important to first highlight that the examples that are being described in the consultation-report are actually "product-based" based rather than "entity-based". Adopting the term "entity-based" may lead to unintended consequences with measures targeting the entire firm ("entity") rather than the specific product the firm is offering.

Thus, we do not consider applying "entity-based" measures to specific firms to be an effective approach in addressing financial stability risks related to NBFI leverage in core financial markets.

Direct limits should not be placed at entity-level or firm level, but on specific products the entity is offering that are identified from the system-wide risk assessment to require some regulatory focus, as was done by CBI for Irish property funds (the measures were targeted at the product and not the entity). Further, as funds are not the only type of vehicle to employ leverage, any limits placed on them risk "leakage" elsewhere in the system. Direct limits also risk cliff edge effects and do not reduce risk but move it to a new "marker". There is a further risk of forced selling if too close to the imposed regulatory leverage limits.

Indirect limits are preferred over direct limits - soft breaches prevent herding

behaviour/threshold effects where changes in market conditions risk triggering simultaneous widespread reactions. They also provide important discretion to fund managers to evaluate and respond to market conditions.

However, there are still drawbacks, as indirect limits may be more complex to implement and monitor and may be difficult to calibrate, thus the system-wide approach is the most appropriate measure to identify risk and tailor the intervention measures in the sector where they are necessary.

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 NBFI leverage?**

    The most successful calibration would be at the product level, specifically looking at the underlying investments, rather than at the entity level. The tools must target the very specific sources of risks rather than the entities themselves, for example, it was the structural issues within the gilts market in combination with the specific LDI strategy which was the source of risk rather than the pension fund itself in the 2022 LDI crisis. It is also important to avoid any procyclical thresholds or yield buffers as they could trigger herd behaviour.

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

    We would advise for any measures to target specific products that are identified from the system wide risk assessment with targeted regulatory intervention, rather than enforce broad entity-based measures. The measures should focus on addressing the specific risks in core markets or with regards to the critical institutions rather than targeting entire entities. Successful examples of targeted solutions include direct structural limits for real estate funds and indirect constraints on leverage such as yield buffer requirements for LDI funds.

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?**

    We consider that a system-wide solution would be most appropriate, and we suggest the most appropriate calibration considerations in the response to Q3.

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 NBFI leverage in core financial markets, such as government bond repo markets? In what circumstances can they be most effective?**

    ICMA is of the strong opinion that the FSB should allow authorities to implement the recently finalised BCBS guidelines for counterparty risk management and to allow time for these to take effect. Only after an assessment of their impact will it be possible to determine if and how these should be enhanced. In particular, ICMA members are supportive of minimum standards applicable to non-banks for the provision of disclosures to bank lenders (as outlined in the BCBS guidelines).

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 NBFI 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?**

    In response to Questions 15, 16 and 17:

There are already extensive regulatory frameworks governing disclosure requirements between banks and their counterparties in the existing Basel CCR framework and as highlighted in response to Q14, authorities should prioritise implementing the recently enhanced BCBS guidelines for Counterparty Credit Risk Management before considering any further disclosure enhancements.

The issue in the case of the Archegos collapse was in the failure of their banking counterparts' risk management practices and the inadequate implementation of existing counterparty risk requirements. The final guidelines, published in December 2024, address these concerns by emphasising the need for comprehensive due diligence, both at initial onboarding and on an ongoing basis. This approach ensures banks have a full understanding of the risks they are taking before making key credit risk decisions and can act swiftly with sufficient information on changing risk profiles during times of stress.

Given that banks already request at least a minimum set of disclosures from each counterparty which can be enhanced as necessary on a bilateral basis (or the banks can refuse to trade with the NBFI if adequate information is not provided), and that leverage users, particularly the highly regulated fund sector, already shares financial information on their exposures with prime brokers at regular intervals, streamlining the information sharing process would greatly benefit all counterparties.

By streamlining information sharing processes and standardising reporting templates it would increase transparency and facilitate the assessment of risk profiles and improve wider counterparty credit risk management functions.

With regards to the principles for minimum set of disclosures described in Q17, it is critical to prioritise proportionality and we particularly agree with the proposed principle that "the granularity of disclosures should be applied proportionately, using a risk-based approach that incorporates the nature, scale and complexity of the risks that a given client poses to its leverage provider". It is essential to preserve the balance between what prime brokers must know to manage a specific counterparty's exposure only and the risk of breaching commercial sensitivities or client confidentiality. The proposed principle "clients should provide aggregate information on their exposures across all entities or vehicles that are managed under a common strategy or decision-making process, to capture the impact of a coordinated

liquidation across the client's full range of related investment products or vehicles" is too broad and risks providing counterparties with too sensitive information on client's exposures.

If the proposed disclosure principles are not proportionate and are too granular and risk breaching commercial sensitivities/client confidentiality, then market participants may be disincentivised to use leverage even for risk hedging purposes.

Finally, The BCBS CCR guidelines already detail the information banks should be requesting when onboarding a counterparty in the onboarding section, it would be helpful for any proposed FSB principles to reflect on these existing guidelines.

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?**

    See response to Q15.

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?**

    See response to Q16.

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?**

    Sharing enhanced disclosures is already standard practice and does not warrant additional regulation. Leverage users are typically required to notify their prime brokers if a fund's NAV falls below a specific threshold compared to its NAV 1, 3 or 12 months prior – this notification trigger allows the prime broker to request additional disclosures and assess any potential issues to take further action. These NAV trigger provisions are detailed in trading agreements such as prime brokerage agreements and ISDA master agreements.

    Prime brokers also have the right to terminate relationships with funds they may deem too risky. This contractual right facilitates prime brokers in requesting additional information without the need for new reporting regimes. The existing NAV trigger mechanism also protects prime brokers from unnecessary information overload which may come with mandated reporting regimes, the existing process allows the identification of funds which are actually at risk rather than inefficiently sifting through vast amounts of data.

    Leverage users may have to notify multiple prime brokers when a fund's NAV falls below a specific threshold, streamlining the reporting process may be beneficial and would facilitate the prime brokers to receive this information in a consistent manner.

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?**

    We are more supportive of standards being implemented via guidance than through regulation or a Code of Conduct. Regulatory consultations and extensive industry engagement/feedback opportunities have been a successful way to input into supervisory guidance and support achieving harmonised policies across jurisdictions.

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?**

    We do not agree with the principle of "same risk, same regulatory treatment" in this context.

    The concept of "same risk" is not always clear-cut, especially when different entities are involved. While market risks may be similar, the overall risk profile can differ between different NBFI entities due to differences in transparency and oversight of their consolidated positions. From this perspective, we agree with the FSB's statement that "when assessing congruence, authorities should have regard to the specific characteristics of different entities, whether the entity is a bank or a non-bank entity, or whether the non- bank entity is already subject to regulatory requirements (…)".

The example cited in the consultation report "incongruences in margining could have an impact on the provision of leverage to non-bank financial entities and their leverage taking behaviour, such as shifting leveraged activities between centrally cleared and non-centrally cleared markets, or between products" is not a representation of "same risk". OTC Derivatives also operate under a robust regulatory framework with margin and reporting requirements.

Preserving the ability for financial markets participants to transact OTC in times of stress is a critical risk mitigation tool as it offers more flexibility regarding collateral requirements and more holistic counterparty credit risk management. Moreover, there are financial instruments such as Significant Risk Transfers (SRTs) which allow banks to shift risks to third-party investors and is considered a successful risk diversification tool.

Finally, regulation must always take into consideration nuances of local and sector specific issues.

Leverage in Non-Bank Financial Intermediation

Consultation report – deadline 28 February 2025

ICMA welcomes this opportunity to comment on the Financial Stability Board's consultation report on *Leverage in Non-Bank Financial Intermediation*. This response represents an ICMA – wide consultation response, led by the Asset Management and Investors Council (AMIC) Committee, the European Repo and Collateral Council (ERCC) as well as feedback from the broader ICMA membership.

ICMA is one of the few trade associations globally that includes both buy-side and sell-side representation. ICMA's buy-side members include asset managers, institutional investors, private banks, pension funds and insurance companies. ICMA's buyside members are represented via its dedicated buyside constituency – the Asset Management and Investors Council (AMIC).

ICMA promotes well-functioning cross-border capital markets, which are essential to fund sustainable economic growth. It is a not-for-profit membership association with offices in Zurich, London, Paris, Brussels, and Hong Kong, serving over 610 members in 70 jurisdictions globally. Its members include private and public sector issuers, banks and securities dealers, asset and fund managers, insurance companies, law firms, capital market infrastructure providers and central banks. ICMA provides industry-driven standards and recommendations, prioritising three core fixed income market areas: primary, secondary and repo and collateral, with cross-cutting themes of sustainable finance and FinTech and digitalisation. ICMA works with regulatory and governmental authorities, helping to ensure that financial regulation supports stable and efficient capital markets.

Executive Summary

As ICMA previously highlighted in its response to the European Commission consultation on macroprudential policies for NBFIs, the critical starting point is for policy makers to acknowledge the heterogeneity of the NBFI sector, and avoid attempting to adapt banking regulation to all entities that have been captured as an NBFI. It would be helpful for the FSB to clearly define the scope of firms intended to be captured under its proposals. Care should also be taken to exclude firms which do not use leverage (e.g. MMFs, non-leveraged pension funds and investment funds).

The FSB and authorities should consider the markets and key institutions that are most critical to financial stability, rather than applying broad measures across all entities. Instead of an exclusively narrow focus on leverage, it should be considered in the context of other factors driving market participants that can, together, contribute to an increase in systemic risk. This is particularly important in light of existing leverage caps and leverage reporting obligations in the highly regulated investment fund space.

The FSB should consider where measures have already been taken in recent years by global regulators, and for the focus to shift instead to aligning jurisdictions' standards, and harmonising reporting requirements, before there has been the opportunity to observe the impact of recently adopted rules and improvements to risk management frameworks.

With regards to the specific activity-based and entity-based measures proposed by the FSB, we consider that:

From an activity perspective, ICMA does not support the introduction of the additional activity-based measures as outlined in Recommendation 5, either in isolation or in combination. None of these proposed measures directly or conclusively address the particular risk that the FSB identifies and instead introduce new risks and market inefficiencies that could undermine market stability.

The additional risks and unintended consequences associated with the recommended activity-based measures include: (i) creating additional costs, frictions, and barriers to entry to the repo market, which is a key source of financial stability; (ii) feeding procyclicality risks in times of heightened market volatility or stress; (iii) not addressing leverage, and in some cases actually facilitating leverage provision (through enhanced cross-netting opportunities); (iv) disincentivising hedging and restricting efficient risk transfer; (iv) reducing the availability of term funding; and (v) detrimentally impacting pricing, liquidity, and investor diversification in core bond markets.

From an entity-perspective, entity-based measures would not address the source of any real issues and risk adding regulatory burden to entities that pose minimum risk or employ no leverage at all. This is well demonstrated in the LDI funds example, where pension funds were not highly leveraged at an entity level, it was the structural issues within the gilts market in combination with the specific LDI strategy which was the source of risk. Applying entity-level leverage limits at the fund level would not have contained the actual risk.

Instead of broad entity-based measures, the measures should be targeted to specific products where risks may manifest. These products should be identified via system-wide, cross-border, systemic counterparty risk assessments performed jointly by authorities.

In addition to system-wide monitoring, authorities should focus on maximising the use of the data collected from the existing extensive reporting requirements, as well as reducing barriers to data sharing both across and within jurisdictions.

Risk identification and monitoring

Recommendation 1: Authorities should have a domestic framework to identify and monitor vulnerabilities related to NBFI leverage and associated financial stability risks in an effective, frequent and timely manner. The domestic framework should be proportionate to the financial stability risks that such vulnerabilities may pose, particularly in core financial markets. Authorities should regularly review their domestic framework and enhance it as appropriate, including the risk metrics utilised, and take steps to improve international consistency in the definition and calculation of those metrics.

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?

We propose that it would be more prudent to consider any financial stability risks caused by leverage specifically from the impact the risks may cause on the core markets and crucial systemically important institutions that are most critical to financial stability rather than applying broad measures across the entire NBFI sector.

The NBFI sector is very heterogenous in the nature of the entities and activities that it captures, and a "one-size fits all" approach would not be effective in identifying and mitigating any potential systemic risks stemming from leverage within the large NBFI sector. It is important to differentiate between the different types of NBFIs and how the different NBFI entities and NBFI activities pose considerably different risks.

Regarding the first channel of risk, the counterparty credit risk channel, it must be noted that much work has been done already with central clearing and margining of non-cleared trades for the whole financial sector, including the NBFI sector. Further work was also conducted in recent years following stress events, including enhancements to banks' counterparty credit risk management through recently finalised BCBS Guidelines on Counterparty Credit Risk Management. The FSB should prioritise consistent implementation of the standards rather than any enhancements.

In relation to the second channel of risk, namely position liquidation channel, this often arises as a result of the regulations relating to the counterparty credit risk channel which can require margining and can be limited in terms of eligible collateral. The FSB, BCBS, CPMI, and IOSCO have conducted extensive work on this topic over recent years, with a focus on addressing transparency and responsiveness of margin requirements in cleared and uncleared markets. Further enhancements would be best addressed by widening the scope of eligible collateral that is permitted and for this to be supported by margining rules.

The repo market plays an important role in providing financing to entities to manage liquidity risk in times of stress which is critical in ensuring that counterparty credit risk does not increase Any effort by authorities to try to curb this by introducing inefficiencies in the repo markets is likely to negatively impact entities' ability to manage liquidity risk which can lead to an increase in counterparty credit risk and therefore systemic risk.

In the regulated fund space, particularly in the open-ended fund (OEF) sector, there are no excessive leverage concerns, which is recognised at both global (IOSCO) and EU levels. At the global level, IOSCO concluded that "OEFs do not have large aggregate exposures through derivatives positions, and consequently are not leveraged by any meaningful impact" [1]. At the EU level, UCITS funds have to comply with a leverage cap of 100% and a borrowing cap of 10%. AIFMs have to demonstrate that the leverage limits for each AIF they manage are reasonable and that they comply with those limits at all times. The total amount of leverage employed is reported to the supervisors (with enhanced reporting obligations for leverage exceeding 300%) and also disclosed to investors. Article 25 of the AIFMD grants the competent authorities the ability to impose leverage limits, or other AIF management restrictions, to contain any build-up of systemic risk attributed to leverage. This is a power which has successfully been deployed by the Central Bank of Ireland, in relation to Irish domiciled real estate funds in November 2022, and more recently in April 2024 on GBP LDI funds in coordination with Luxembourg's CSSF.

ESMA also conducts liquidity stress testing guidelines[2] which require managers to ensure they are prepared to meet redemptions and liquidity demands from margin calls. ESMA has recently assessed risks posed by leveraged AIFs in the EU[3] and has concluded that NCAs have the right tools to take an accurate view of risks in their jurisdiction.

Leverage can be an important tool for investors to hedge both market and liquidity risks. Its impact is heavily dependent on how it is used (hedging of risk vs taking risk exposure) and the type of NBFI entity. As described above, in the highly regulated OEFs space, the existing leverage caps and reporting obligations contain any possible source of systemic leverage risk.

The Consultation Report refers specifically to the risk hedge funds pose as they may "often employ substantial leverage to amplify returns, which can lead to rapid deleveraging during market stress, causing significant price movements and affecting liquidity in the underlying assets". It is important to note the growing important role of hedge funds as liquidity providers particularly in the bond market rate space. Furthermore, hedge funds are not a homogenous investor class and are quite diverse in terms of strategies and investment objectives. The relative value nature of many strategies means that they are often agnostic to directional trends which can add a helpful countercyclical element to the market. Furthermore, some of the more algo-driven, arbitrage-based trading strategies help to maintain market efficiency while also generating liquidity.

The role of hedge funds is recognised in a September 2024 ECB blog post "Hedge funds: good or bad for market functioning?"[4] where the ECB highlights concerns that the employment of leverage by hedge funds could raise risks of amplification in the case of market volatility, but they currently find no evidence to support this. Using repo data as a means to identify hedge fund activity (noting that hedge funds use the repo market extensively to finance both long and short bond exposures), the ECB observes an inverse relationship between hedge fund leverage and underlying market volatility.

Also noted by the ECB, hedge funds are reliant on banks' balance sheets to support their investment strategies, particularly through the provision of repo liquidity. Accordingly, the ability for such funds to acquire leverage is contained by already strict capital rules imposed on banks.

---

[1] FR01/23 IOSCO Investment Funds Statistics Report

[2] esma34-39-882_final_report_guidelines_on_lst_in_ucits_and_aifs.pdf

[3] ESMA60-1389274163-2572 TRV article - Assessing risks posed by leveraged AIFs in the EU

[4] Hedge funds: good or bad for market functioning?

The Consultation Report also outlines concerns around leverage users having multiple brokers which could result in excessive or hidden leverage. As was seen during the GFC, concentrating relationships with a single broker exposes leverage users to the risks associated in case the prime broker fails – 40% of Lehman Brothers' clients that used it as their sole prime broker were liquidated following its bankruptcy, compared to only 4% of those with multiple prime brokers[5]. Diversifying prime broker relationships is thus a critical mitigation tool and we would therefore strongly advise against any measures that would concentrate the number of prime brokers leverage users could use.

From the examples provided in the consultation report, particularly Archegos, the issues have not stemmed from any over leveraged NBFIs, but the knock-on consequences for critical institutions like banks, in this case Credit Suisse. Ultimately, any leverage-related regulatory intervention measures which are identified on financial stability grounds, must avoid outweighing the benefits that leverage facilitates in the markets and the real economy in terms of investment, trading and hedging risk.

Thus, to address potential sources of systemic leverage, which is already well contained within the highly regulated NBFI sector, we consider that the priority focus should be on developing the effective monitoring and supervision of the wider NBFI universe through market surveillance, and cooperation, by way of system-wide, cross-border, systemic counterparty risk monitoring (to be conducted jointly by authorities, i.e. market authorities and banking supervisors), leveraging existing data as a priority to avoid any additional burden.

Moreover, we believe that alongside a consideration of the risks presented by NBFI leverage, the FSB and national authorities should recognise the role of the banking prudential framework as a corollary to risks in certain markets. In some cases, banking regulation has had inadvertent consequences on market functioning, by making it more difficult for banks to act. For example, the Federal reserve took emergency action[6] to disapply the supplementary leverage ratio from US treasuries, as it was preventing banks from intermediating in the market during the "dash for cash" episode in March/April 2020. The FSB should reconsider measures that are inadvertently making it more difficult for banks to provide liquidity, with a view to optimising financial stability.

The Bank of England System-Wide Exploratory Scenario exercise is a good example of a market-wide assessment to understand risks to and from NBFIs, and the behaviour of NBFIs and banks in stress, as well as how their behaviours and market dynamics can amplify shocks and pose any potential risks to financial stability[7] . In response to Q3, we describe some considerations for the most appropriate calibration of a system-wide assessment.

Ultimately, it must be noted the risk of these proposed measures of likely introducing friction and inefficiencies, and how they could hinder the NBFI sector to support growth of its local economies and lead to a contraction of investments.

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?

As highlighted in response to Q1, it is firstly important to acknowledge the different positive use cases for leverage and how it is actually used in the NBFI sector in certain scenarios to mitigate

---

[5] Hedge Funds and Prime Broker Risk, Valeri Sokolovski

[6] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200401a.htm

[7] The Bank of England's system-wide exploratory scenario exercise final report | Bank of England

financial stability risks. For instance, counterparties may choose to increase leverage, through repo financing, to meet margin calls, in order to reduce counterparty credit risk.

Out of the four proposed risk metrics (leverage metrics, collateralisation, sensitivity to market risk, concentration risk), we consider leverage metrics to be the most appropriate measure to identify and monitor financial stability risks arising from NBFI leverage.

From an international perspective, leverage metrics can already be considered from a cross-border perspective. At the EU level, ESMA regularly assesses the Leverage Risk embedded in the activities of EU AIFs and discloses this information in its periodic risk reports.

Generally, there is no specific leverage threshold that triggers a potential financial stability risk. It is dependent on what leverage is being used for (investment or hedging purposes) and whether it has the ability to negatively impact a core market, in which case targeted tools should be deployed. The failure of Archegos is a prime example as its default was significant because of its impact on a specific global systemically important financial institution (Credit Suisse), not because Archegos itself had any systemic significance as a sole financial sector entity.

We consider that the most important starting point is for authorities to focus on their use of all the existing reporting requirements which are already extensive (e.g. G20 Derivative Reporting Rules (e.g. EMIR reporting, MAS, ASIC, MiFID) and SFT Rules (SFTR, new OFR rules being implemented in the US) across instrument types), as well as to reduce barriers to data sharing both across and within jurisdictions.

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?**
(ii) **specific types of entities, such as hedge funds, other leveraged investment funds, insurance companies and pension funds?**
(iii) **concentration and crowded trading strategies?**

We consider the starting point for the most effective monitoring of financial stability risks should be the prioritisation of the effective use of data through the existing reporting requirements, such as the derivatives and SFTs reporting requirements, but also margin transparency and the extension of types of collateral accepted for cleared and uncleared derivatives.

Regulatory monitoring of financial stability risks at the macro-level is an important complement to the due diligence, monitoring and risk management conducted by individual financial institutions. As highlighted previously, the BoE SWES exercise is a good example of system wide monitoring, and we would consider a system wide solution to be the most appropriate tool to monitor financial stability risks resulting from the different variants listed in the question.

Unlike the stress-tests that central banks and regulatory authorities conduct on an annual basis to assess the resilience of each individual firm, the system wide assessment includes a much broader range of market participants in order to understand the interactions between the different types of financial institutions and the potential amplification of shocks. This facilitates the identification of any risks to and from NBFIs and any system-wide vulnerabilities which could impact financial stability.

To ensure the effectiveness of a system-wide exercise, we advise on certain conditions that should be met to ensure its effectiveness:

- System-wide tests should have a well-defined objective, focusing on how all market participants affect a specific market under a particular scenario.
- These tests should serve as information-gathering tools, not as a means to establish macroprudential policies for non-banks or to set prescriptive rules for individual firms (e.g. liquidity ratios or prudential requirements for banks).
- Supervisors should not make assumptions about market participant behaviour.
- Responses to scenarios should be based on participants' real-world experience, rather than hypothetical simulations created by supervisory authorities.
- It's important to acknowledge that each participant's behaviour and options will be influenced by their counterparties' decisions and reactions, as well as policymaking and the regulatory framework they operate under. Understanding these interdependencies is crucial to make any accurate assessments.
- It should be proportionate and have a defined time frame. Given the data and resource-intensive nature of these tests for firms, they should not be conducted any more frequently than on a 5-year basis.
- Given the global nature of financial markets, jurisdictions should coordinate their assessments to help identify and mitigate any potential cross-border system risks. This coordination is also important in order to avoid excessive regulatory burden on financial market participants.

Recommendation 2: Authorities should review their domestic framework to assess data challenges, including on (i) authorities' usage of available data, (ii) the quality, frequency and timeliness of available data, (iii) authorities' access to relevant data and (iv) potential data gaps within existing reporting requirements. Authorities should seek to address data challenges and, where appropriate, collaborate through the FSB and SSBs to reduce those challenges that may hinder the effective cross-border monitoring of vulnerabilities, as set out in Recommendation 9.

Recommendation 3: Authorities should **review the level of granularity, frequency, and timeliness of existing public disclosures and determine the degree to which additional or enhanced disclosures should be provided to the public, either by (i) authorities, including disclosure based on regulatory reporting data, (ii) the relevant financial market infrastructure providers or (iii) directly by financial entities, balancing the costs and benefits of doing so.** This includes dissemination by authorities of data and information on aggregate market positioning and transaction volumes based on existing regulatory reporting. **Such additional or enhanced disclosures should be designed and calibrated to increase transparency especially about concentration risk and crowdedness**, with the aim to support market participants' ability to manage risks from NBFI leverage and estimate counterparty exposures and liquidation costs.

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?

We do not consider that enhancing public disclosures would support market participants in enhancing their liquidity or counterparty credit risk management. Transparency can be beneficial in some circumstances, but there are trade-offs to take into consideration, particularly in the case of public disclosures where it could reveal positions which could be detrimental to some business interests.

From a fiduciary duty perspective, financial entities cannot be forced to make public any information which may harm their clients' interests. From a risk management perspective, exposing positions of liquidity providers could also harm liquidity provision and pricing. Public disclosures also risk sending the wrong signal to the market and triggering herd behaviour of fire sales.

There are already extensive robust pre-and post-trade reporting requirements and public disclosures in most jurisdictions. Authorities should prioritise assessing the effectiveness of the information sharing between the jurisdictions and simplify reporting procedures where possible. The priority focus should be on international harmonisation of existing disclosures, especially in the already highly regulated markets of the US, EU and UK.

NBFI leverage in core financial markets

Recommendation 4: Authorities should take steps to address the financial stability risks from NBFI leverage that they identify in core financial markets. Activity-based and entity-based measures and measures aimed at addressing concentration that amplifies risks related to NBFI leverage, should be reviewed periodically and enhanced where appropriate, including to address risks from a system wide perspective. The measures should be selected and calibrated to be effective and proportionate to the identified financial stability risks. Where existing legal and regulatory frameworks do not provide the necessary policy measures to address identified financial stability risks, authorities should consider adjusting or widening the scope of such frameworks, where appropriate.

Recommendation 5: When selecting policy measures to address financial stability risks from NBFI leverage in core financial markets, authorities should evaluate a wide range of measures, including both activity and entity-based measures, as well as concentration related measures. Authorities' choice of measures should be based on the nature and drivers of identified risks, taking into account their expected effectiveness and any potential costs or unintended consequences, as well as measures taken in other jurisdictions to address similar risks. Activity-based measures include (i) minimum haircuts in SFTs, including government bond repos, (ii) enhanced margining requirements between non-bank financial entities and their derivatives counterparties, and (iii) central clearing mandates in SFT and derivatives markets. Entity-based measures include (i) direct limits on leverage, and (ii) indirect leverage constraints linked to risks that non-bank financial entities are exposed to. Concentration measures include (i) concentration add-ons for margins and haircuts in connection with exposures of non-bank financial entities in derivatives and SFT markets, (ii) concentration and large exposure limits, and (iii) large position reporting requirements.

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?

Recommendations 4 and 5 help to emphasise the importance of prudential and market regulators having a sufficient level of market visibility in order to identify potential build ups of leverage-related risks that could threaten financial stability before introducing any new policy interventions, while also highlighting the inadequacies of activity-based measures. As explained in the response to Question 6, regulatory frameworks already exist, or are still being implemented, that are designed to limit the amount of leverage that can be provided to non-bank financial entities. It is not clear how introducing the proposed additional activity-based measures, even if calibrated at the entity level, would achieve the stated objective of containing leverage-related risks to financial stability. On the contrary, the proposed activity-based recommendations appear to pose a greater threat to broader market functioning and stability.

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 NBFI leverage in core financial markets, including government bond markets? To what extent can these three types of policy measures complement each other?

ICMA does not support the introduction of activity-based measures as outlined in Recommendation 5, either in isolation or in combination. None of these proposed measures directly or conclusively address the particular risks that the FSB identifies (i.e. containing and mitigating NBFI leverage that *may* create risks to financial stability) and instead introduce new risks and market inefficiencies that could undermine market stability.

(i) Minimum haircuts in securities financing transactions

ICMA does not support the introduction of minimum haircuts for securities financing transactions for a number of reasons.

Firstly, it is important to recognise that a capital-based regulatory framework already exists that effectively contains the ability of banks to provide leverage to non-banks. This includes the application of capital risk weightings that are calibrated for both the counterparty and the collateral, both in the standardised approach (SA) and banks' internal models (IM). Furthermore, the introduction of the Output Floor (OF) will effectively increase the risk weightings currently applied under IMs. If the FSB has reason to believe that the current regulatory framework, including measures still to be implemented, does not serve its purpose, then it should review the existing calibration rather than introducing additional layers of regulation.

Secondly, a minimum haircut framework would suggest that all non-bank counterparties are alike. As highlighted elsewhere in this response, NBFIs cannot be grouped together and assessed as a homogenous entity. In reality, NBFIs have very different risk and leverage profiles, and use SFTs for a variety of purposes. Thus, a one-size-fits-all solution would not be appropriate. For a minimum haircut framework to even begin to make sense it would need to be calibrated to account for the specific counterparty risk, which is essentially what the existing regulatory risk capital framework seeks to do.

Thirdly, while haircuts are intended to manage the liquidity risk of the underlying securities (i.e. liquidation risks in the event of default), they have a direct impact on counterparty credit risk. In the case of applying minimum haircuts, this could be distortive. Specifically, an NBFI of higher credit quality than a counterparty bank would be increasing its credit risk to the bank as a result of being charged a haircut. This would increase overall credit risk in the system, counter to the FSB's explicit objectives.

Fourthly, applying minimum haircuts to individual trades does not support the objective of containing overall counterparty leverage. In determining the haircut policy for different SFT transactions with various counterparties, banks make their assessments based on the total aggregate exposure to the counterparty and the cost of capital associated with doing business, and not purely at the individual transaction level. For example, a prime broker may hold significant assets in custody for a client compared to the amount of leverage being provided. In this instance it is not clear, from an overall leverage perspective, what would be achieved by applying a minimum haircut to an individual repo transaction, other than making the trade, in itself, more expensive for the client.

Fifthly, as highlighted in some of the previous points, mandatory minimum haircuts would simply make the cost of transacting SFTs more expensive for non-banks, regardless of their risk or leverage profile, or their motivation for participating in the market. Increasing minimum haircuts for SFTs, will create additional costs and frictions in normal market conditions, that would become even more pronounced in times of heightened volatility or market stress. SFT markets, particularly the repo market, are a source of market stability, facilitating short-term liquidity management and collateral transformation. Adding costs and frictions to the market, particularly in times of heightened volatility or market stress, would seem to be counterproductive to the objective of maintaining financial stability, and could even exacerbate fire-sales or 'dash-for-cash' scenarios, as market participants struggle to meet increasing margin calls. Which raises the question of whether a countercyclical approach to SFT haircuts would make more sense from a market stability perspective (i.e. maximum haircuts).

Finally, and related to the additional cost to transacting SFTs as a result of minimum haircuts, consideration also needs to be given to the impact on the underlying market, not least core government bond markets. A more expensive and less liquid repo market, with fewer participants, will have a knock-on impact in the outright market, widening bid-ask spreads in the secondary market and new issuance premium in the primary market. Accordingly, the seemingly limited benefits of minimum haircuts also need to be assessed against the wider macroeconomic impacts of raising sovereign borrowing costs, as well as any unintended consequences for financial stability.

It is also important to note that the FSB's Minimum Haircut Framework, which is referenced in the report, has not been implemented in any of the large financial market jurisdictions given in part due to the concerns highlighted above, combined with concerns[8] about the efficacy of the framework itself.

(ii) Enhanced margin requirements between non-bank financial entities and their derivatives counterparties

---

[8] GFMA-and-ICMA-Repo-Market-Study_Post-Crisis-Reforms-and-the-Evolution-of-the-Repo-and-Broader-SFT-Markets_171218.pdf

ICMA would like to point out that there is already in existence a robust global regulatory framework for both cleared and non-cleared derivatives transactions which was implemented by the G20 following the 2008 global financial crisis. A number of improvements to the framework have already been identified, as highlighted in the recently published reports from the BCBS, CPMI, and IOSCO,[9] not least with respect to enhanced transparency of CCP margining models.

However, ICMA is keen to point out that any additional margin requirements related to cleared or non-cleared derivatives transactions need to be balanced against the increased risk of procyclicality. As has been observed in a number of instances, in times of heightened volatility variation margin requirements can increase significantly and quickly, often intraday, which increases reliance on an accessible and liquid repo market as well as triggering sales of (usually higher quality) assets, which are not necessarily leveraged holdings. This can undermine market stability, increasing the risk of a financial crisis.

Moreover, as correctly alluded to in the consultation report, increasing the cost of using derivatives can be a deterrent to hedging and the smooth functioning of risk transfer, thereby increasing systemic risk.

As a further consideration, intended to reduce potential pro-cyclical risks of variation margin calls on centrally-cleared markets, we suggest to extend eligible collateral to HQLA, in particular government bonds.

Regulators should thus amend rules on collateral so that they: i) take a holistic, and systemic, approach to the regulation of collateral, and of activities requiring collateral; ii) are consistent across different types of activity, and across different types of market participants; and iii) ensure that market participants can pool collateral. One example would be to allow central counterparties to diversify where they can hold collateral rather than restrict them to posting collateral with central securities depositories.

Finally, ICMA would emphasise the importance of maintaining robust processes to determine which derivatives products are subject to central clearing mandates to ensure that only appropriately liquid products are mandated for clearing. This should not be expanded arbitrarily to products that are not suitable for clearing.

(iii) Central clearing of securities financing transactions

ICMA is fully supportive of removing regulatory barriers to non-bank access to central clearing for outright and repo transactions in appropriately liquid cash securities, such a government bonds. Central clearing provides several potential benefits in the context of SFTs, including increased settlement efficiency, and improved access to market liquidity. However, ICMA opposes the notion of mandating central clearing for cash securities, noting that the decision to clear should be based on commercial considerations and sound risk management without undue constraints. There are several reasons why ICMA considers the recommendation of mandating central clearing for SFTs to be misguided and risky.

Firstly, it is not entirely clear whether increasing clearing for SFTs would help to constrain leverage. As noted in the consultation report, different models exist to facilitate non-bank access to a CCP. In some models, the sponsoring or agent bank posts the initial margin, which would defeat the main argument underlying the recommendation. Also, again as recognised in

[9] https://www.bis.org/press/p250115.htm

the consultation report, cross-product margining arrangements provided by many CCPs, which requires margin against a net exposure, could actually increase the availability of leverage to some entities. For example, the much-reported basis trades popular with certain investor types (which involve both a bond futures and repo position) could be more efficiently (i.e. cheaply) margined if the repo is centrally cleared, compared to it being transacted bilaterally.

Secondly, and very importantly, mandating central clearing for SFTs would introduce procyclicality risks to the market. As already highlighted, the repo market in particular is an importance source of market stability, facilitating short term liquidity and collateral transformation. Financial institutions (bank and non-bank) rely on the repo market in order to meet margin calls against their derivatives exposures, which are often hedges. By subjecting repo positions to the risk of significant spikes in variation margin in times of heightened volatility, compared to bilateral repo arrangements, would require even more collateral being required to raise cash to meet margin calls more broadly. This is particularly pertinent in the case of non-bank entities that are predominantly one-directional in terms of repo activity (i.e. lending securities to raise cash), such as pension funds. This would heighten the probability of margin calls being missed, so increasing counterparty credit risk, while diminishing the repo-able value of institutions' high quality liquid assets, thereby increasing market risk.

Thirdly, it is important to recognise the important role that the repo market plays in maturity transformation, allowing financial institutions to secure term funding against their assets. Centrally clearing term repo trades, without the potential for margin netting, can be prohibitively expensive due to the high levels and associated uncertainty of variation margin. This creates a natural bias to very short-dated repo transactions when centrally cleared, which can be observed, for instance, in the US Treasury repo market. Mandating central clearing for SFTs would severely restrict the ability of many non-banks to access term funding, creating a systemic reliance on very short-dated repo financing. Such a lack of diversity in financing tenors would be an additional risk to financial stability, particularly in the case of short-term funding shocks.

Fourthly, and also associated with the relative cost of transacting cleared SFTs compared to bilaterally, this would create a potential barrier to accessing the repo market. It is often purported that CCPs create more balance sheet netting opportunities for banks, which should help support more intermediation and deeper liquidity. However, recent studies reveal that on average the benefits of uniform clearing would be relatively modest and largely limited to very short-dated repo.[10] What receives less attention is the fact that increasing banks' exposures to CCPs would also have impacts with respect to liquidity, risk weighted capital, and single counterparty credit limits. In other words, the Leverage Ratio is not the only limiting constraint on banks' balance sheets.

For many non-banks, the cost of clearing SFTs will be prohibitively expensive. As with minimum haircuts for bilateral transactions, consideration needs to be given to the impact on pricing,

---

[10] See: *Balance-Sheet Netting in U.S. Treasury Markets and Central Clearing*, David Bowman, Yesol Huh, and Sebastian Infante, Federal Reserve Board, June 2024; and *The potential impact of broader central clearing on dealer balance sheet capacity: a case study of UK gilt and gilt repo markets*, Yuliya Baranova, Eleanor Holbrook, David MacDonald, William Rawstorne, Nicholas Vause, and Georgia Waddington, Bank of England, June 2023

liquidity, intermediation, and investor diversification in the underlying market, and the wider impacts on government borrowing costs as well as financial stability.

While some jurisdictions are beginning to explore the possibility of mandating central clearing for government bond markets, many will share the concerns we have outlined and will most likely wait to assess the impacts and lessons learned of its projected implementation in the US. ICMA would therefore, as a minimum, suggest waiting for the full effect of the US mandate to be realised and digested before recommending broad adoption.

For the reasons outlined above, ICMA cannot endorse any of the proposed activity-based measures. In isolation, each would create more risks than they seek to address. In combination, these risks would only be compounded.

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?

As discussed in the response to Question 6, dynamic approaches to minimum margin and haircut requirements have the potential to increase the risk of procyclicality in instances of heightened market volatility or stress. In other words, these could act as accelerators for market volatility and so feed financial instability. Increased volatility should be a natural incentive to de-lever, without the additional stress caused by increasing margin requirements further.

In the case of SFTs, it is also important to note that the application of dynamic haircuts or margining would undermine the integrity of the market. Market participants use the repo market for certainty of funding. If they cannot predict with some degree of certainty the cost of borrowing over their required funding horizon, this compromises the basic premise of a functioning market, while simultaneously adding more risk into the system.

Some ICMA members note that where dynamic adjustments exist elsewhere, such as banking regulation, they work in a countercyclical way (e.g. the Countercyclical Capital Buffer). A suggestion for consideration is that a similar approach be taken to any minimum margin or haircut requirements.

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

The consultation report has overlooked many of the unintended consequences that are associated with the proposed activity-based recommendations, and that have been described in the response to Question 6. These can be summarised as:

- Creating additional costs, frictions, and barriers to entry to the repo market, which is a key source of financial stability.
- Feeding procyclicality risks in times of heightened market volatility or stress, particularly with respect to counterparty credit risk and market risk.
- Not addressing leverage and in some cases actually facilitating leverage provision.
- Disincentivising hedging and restricting efficient risk transfer.
- Reducing the availability of term funding (beyond very short-dated repo).

- Detrimentally impacting pricing, liquidity, and investor diversification in core bond markets (with macroeconomic knock-on effects from raising the cost of government borrowing).

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

In the case of non-cleared SFTs, margin requirements and haircuts are not directly comparable.

Margin requirements are generally applied at the entity level based on its overall portfolio of exposures. This could include non-cleared derivatives, repos and reverse repos, as well as prime brokerage financing, among other exposures. This allows banks to make more accurate risk assessments based on a range of criteria, including factors such as aggregate leverage or co-correlation risks.

Haircuts, however, are applied at the individual transaction level in the case of SFTs. Theoretically, haircuts also serve a different purpose. Since the collateral underlying the transaction is intended to mitigate against counterparty credit risk, the haircut is a mitigant against market liquidity risk (i.e. the expected price slippage in liquidating the collateral in the event of default).

In reality, depending on banks' risk management models, haircuts can be calibrated both on counterparty credit risk as well as the underlying collateral, but also as a means to manage their capital risk weightings (i.e. to reduce RWAs). As explained in the response to Question 6, they are not a very effective tool for containing counterparty leverage, and imposing needlessly high haircuts would only be market-distortive, with the unintended consequences for pricing, liquidity, and access that brings.

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?

It is important to first highlight that the examples that are being described in the consultation-report are actually "product-based" based rather than "entity-based". Adopting the term "entity-based" may lead to unintended consequences with measures targeting the entire firm ("entity") rather than the specific product the firm is offering.

Thus, we do not consider applying "entity-based" measures to specific firms to be an effective approach in addressing financial stability risks related to NBFI leverage in core financial markets.

Direct limits should not be placed at entity-level or firm level, but on specific products the entity is offering that are identified from the system-wide risk assessment to require some regulatory focus, as was done by CBI for Irish property funds[11] (the measures were targeted at the product and not the entity). Further, as funds are not the only type of vehicle to employ leverage, any limits placed on them risk "leakage" elsewhere in the system. Direct limits also risk cliff edge effects and do not reduce risk but move it to a new "marker". There is a further risk of forced selling if too close to the imposed regulatory leverage limits.

[11] Macroprudential measures for Irish property funds

Indirect limits are preferred over direct limits - soft breaches prevent herding behaviour/threshold effects where changes in market conditions risk triggering simultaneous widespread reactions. They also provide important discretion to fund managers to evaluate and respond to market conditions.

However, there are still drawbacks, as indirect limits may be more complex to implement and monitor and may be difficult to calibrate, thus the system-wide approach is the most appropriate measure to identify risk and tailor the intervention measures in the sector where they are necessary.

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 NBFI leverage?

The most successful calibration would be at the product level, specifically looking at the underlying investments, rather than at the entity level. The tools must target the very specific sources of risks rather than the entities themselves, for example, it was the structural issues within the gilts market in combination with the specific LDI strategy which was the source of risk rather than the pension fund itself in the 2022 LDI crisis. It is also important to avoid any procyclical thresholds or yield buffers as they could trigger herd behaviour.

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

We would advise for any measures to target specific products that are identified from the system wide risk assessment with targeted regulatory intervention, rather than enforce broad entity-based measures. The measures should focus on addressing the specific risks in core markets or with regards to the critical institutions rather than targeting entire entities. Successful examples of targeted solutions include direct structural limits for real estate funds and indirect constraints on leverage such as yield buffer requirements for LDI funds.

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?

We consider that a system-wide solution would be most appropriate, and we suggest the most appropriate calibration considerations in the response to Q3.

Interlinkages with systemically important financial institutions

Recommendation 6: Authorities should ensure the timely and thorough **implementation of the BCBS's guidelines on counterparty credit risk** which represents an important element of a comprehensive policy response to financial stability risks stemming from NBFI leverage. Authorities, in cooperation with SSBs, **should monitor, including from a systemic perspective, ongoing and future developments in the way NBFI leverage is provided** to ensure that the regulatory framework remains appropriate for the consistent treatment of risks.

14. How could counterparty credit risk management requirements for leverage providers be enhanced to be more effective in addressing financial stability risks from NBFI leverage in

core financial markets, such as government bond repo markets? In what circumstances can they be most effective?

ICMA is of the strong opinion that the FSB should allow authorities to implement the recently finalised BCBS guidelines for counterparty risk management[12] and to allow time for these to take effect. Only after an assessment of their impact will it be possible to determine if and how these should be enhanced. In particular, ICMA members are supportive of minimum standards applicable to non-banks for the provision of disclosures to bank lenders (as outlined in the BCBS guidelines).

Recommendation 7: Authorities, in cooperation with SSBs**, should review the adequacy of existing private disclosure** practices between leveraged non-bank financial entities and leverage providers, including **the level of granularity, frequency, and timeliness of such practices.** Where appropriate, they should consider developing **mechanisms and/or minimum standards to enhance the effectiveness of these disclosure practices**.

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 NBFI 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?

In response to Questions 15, 16 and 17:

There are already extensive regulatory frameworks governing disclosure requirements between banks and their counterparties in the existing Basel CCR framework and as highlighted in response to Q14, authorities should prioritise implementing the recently enhanced BCBS guidelines for Counterparty Credit Risk Management before considering any further disclosure enhancements.

The issue in the case of the Archegos collapse was in the failure of their banking counterparts' risk management practices and the inadequate implementation of existing counterparty risk requirements. The final guidelines, published in December 2024, address these concerns by emphasising the need for comprehensive due diligence, both at initial onboarding and on an ongoing basis. This approach ensures banks have a full understanding of the risks they are taking before making key credit risk decisions and can act swiftly with sufficient information on changing risk profiles during times of stress.

Given that banks already request at least a minimum set of disclosures from each counterparty which can be enhanced as necessary on a bilateral basis (or the banks can refuse to trade with the NBFI if adequate information is not provided), and that leverage users, particularly the highly regulated fund sector, already shares financial information on their exposures with prime brokers at regular intervals, streamlining the information sharing process would greatly benefit all counterparties.

By streamlining information sharing processes and standardising reporting templates it would increase transparency and facilitate the assessment of risk profiles and improve wider counterparty credit risk management functions.

[12] https://www.bis.org/bcbs/publ/d588.pdf

With regards to the principles for minimum set of disclosures described in Q17, it is critical to prioritise proportionality and we particularly agree with the proposed principle that "the granularity of disclosures should be applied proportionately, using a risk-based approach that incorporates the nature, scale and complexity of the risks that a given client poses to its leverage provider". It is essential to preserve the balance between what prime brokers must know to manage a specific counterparty's exposure only and the risk of breaching commercial sensitivities or client confidentiality. The proposed principle "clients should provide aggregate information on their exposures across all entities or vehicles that are managed under a common strategy or decision-making process, to capture the impact of a coordinated liquidation across the client's full range of related investment products or vehicles" is too broad and risks providing counterparties with too sensitive information on client's exposures.

If the proposed disclosure principles are not proportionate and are too granular and risk breaching commercial sensitivities/client confidentiality, then market participants may be disincentivised to use leverage even for risk hedging purposes.

Finally, The BCBS CCR guidelines already detail the information banks should be requesting when onboarding a counterparty in the onboarding section, it would be helpful for any proposed FSB principles to reflect on these existing guidelines.

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?

See response to Q15.

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?

See response to Q16.

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?

Sharing enhanced disclosures is already standard practice and does not warrant additional regulation. Leverage users are typically required to notify their prime brokers if a fund's NAV falls below a specific threshold compared to its NAV 1, 3 or 12 months prior – this notification trigger allows the prime broker to request additional disclosures and assess any potential issues to take further action. These NAV trigger provisions are detailed in trading agreements such as prime brokerage agreements and ISDA master agreements.

Prime brokers also have the right to terminate relationships with funds they may deem too risky. This contractual right facilitates prime brokers in requesting additional information without the need for new reporting regimes. The existing NAV trigger mechanism also protects prime brokers from unnecessary information overload which may come with mandated reporting regimes, the existing process allows the identification of funds which are actually at risk rather than inefficiently sifting through vast amounts of data.

Leverage users may have to notify multiple prime brokers when a fund's NAV falls below a specific threshold, streamlining the reporting process may be beneficial and would facilitate the prime brokers to receive this information in a consistent manner.

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?

We are more supportive of standards being implemented via guidance than through regulation or a Code of Conduct. Regulatory consultations and extensive industry engagement/feedback opportunities have been a successful way to input into supervisory guidance and support achieving harmonised policies across jurisdictions.

Addressing incongruences in regulatory treatment of NBFI leverage

Recommendation 8: Authorities should adopt the principle of "same risk, same regulatory treatment" and identify incongruences in the regulatory treatment of NBFI leverage resulting from similar exposures, financial instruments or structures that may distort incentives and result in regulatory arbitrage. Where incongruences are identified, authorities, in cooperation with SSBs, should analyse the underlying causes to determine whether and how to address the identified incongruences, having regard to the treatment of similar situations in other jurisdictions, so that domestic remediation efforts do not create new disparities that could transfer risk across borders.

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?

We do not agree with the principle of "same risk, same regulatory treatment" in this context. The concept of "same risk" is not always clear-cut, especially when different entities are involved. While market risks may be similar, the overall risk profile can differ between different NBFI entities due to differences in transparency and oversight of their consolidated positions. From this perspective, we agree with the FSB's statement that "when assessing congruence, authorities should have regard to the specific characteristics of different entities, whether the entity is a bank or a non-bank entity, or whether the non- bank entity is already subject to regulatory requirements (...)".

The example cited in the consultation report "incongruences in margining could have an impact on the provision of leverage to non-bank financial entities and their leverage taking behaviour, such as shifting leveraged activities between centrally cleared and non-centrally cleared markets, or between products" is not a representation of "same risk". OTC Derivatives also operate under a robust regulatory framework with margin and reporting requirements. Preserving the ability for financial markets participants to transact OTC in times of stress is a critical risk mitigation tool as it offers more flexibility regarding collateral requirements and more holistic counterparty credit risk management. Moreover, there are financial instruments such as Significant Risk Transfers (SRTs) which allow banks to shift risks to third-party investors and is considered a successful risk diversification tool.

Finally, regulation must always take into consideration nuances of local and sector specific issues.

Cross-border cooperation and coordination

Recommendation 9: When addressing risks created by NBFI leverage that may emanate from, transmit to, or otherwise impact markets and market participants in other jurisdictions, authorities should engage proactively with their peers to facilitate coordinated crisis and/or policy responses, to the extent legally and operationally feasible. To enhance system wide risk monitoring across jurisdictions, authorities should proactively establish information sharing agreements, such as through MoUs, and regular communication channels or engagement processes, where they determine that doing so would assist in their ability to identify and assess relevant market risks, especially during crises. Authorities should also share aggregate data on leverage in key non-bank financial sectors on a best effort basis and make use of harmonised data and metrics as much as possible when exchanging information with each other.