FSB FINANCIAL STABILITY BOARD

Leverage in Non-Bank Financial Intermediation: Consultation report

Response to Consultation

International Swaps and Derivatives Association (ISDA)

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?**

   In our response to this question, we provide feedback not just on Recommendation 1, but also on the sections of the report that discuss NBFI leverage and financial stability risks under Section 2.

   Scope

   The report sets out how the focus is on leverage "where it can create financial stability risks" in Section 2.2, referring to "financial markets that are at the core of the financial system". However, the report does not define what such core financial markets are. The term "core financial markets" is then used throughout the report, including in Recommendation 1, but the precise scope of which markets are covered remains unclear. The report, on page 21, suggests that such core financial markets would include government bond cash and repo markets, or real estate investment markets, but the precise scope is not defined. We would encourage the FSB to further define in which markets leverage may create such financial stability risks, and which financial markets are deemed as core to the financial system. For example, the concept of "core financial markets" should exclude commodity markets as these operate fundamentally differently and serve a different purpose compared to other financial markets which may be deemed as "core financial markets", such as government bond and repo markets.

   We would also highlight that many NBFIs are already subject to restrictions on leverage. For example, in the EU, leverage is already captured in several ways. For funds regulated under the Undertakings for Collective Investment in Transferable Securities (UCITS) directive, leverage is capped. For funds regulated under the Alternative Investment Funds Managers (AIFM) directive, in the case of leverage above 300%, a strict enhanced reporting obligation to securities regulators already applies. In addition, national competent authorities can require additional constraints. In all those cases, EU regulated funds such as UCITS and AIFMs cannot therefore build up excessive leverage.

   Description of financial stability risks from leverage

In addition, as acknowledged in Section 2.1, leverage, as a technique, is a key feature of a well-functioning financial system. Activities involving leverage support key functions, such as facilitating hedging, providing funding, arbitraging price discrepancies and restoring market equilibria where imbalances build up.

The FSB defines risks to financial stability from leverage in terms of two channels. The "position liquidation channel" involves sudden deleveraging and asset sales during stress, while the "counterparty channel" spreads financial stress from one counterparty's default to others.

Regarding the counterparty channel, it is important to note that post-2008 reforms have significantly reduced counterparty credit risk in the financial system, through margining and central clearing requirements, as well as through increased resilience levels required from leverage providers. The

recent publication of the BCBS Guidelines for counterparty credit risk management, which ISDA commented on during the consultation, further supports banks and supervisory authorities on the management of counterparty credit risk, with a risk-based and proportionate application of the guidelines.

As such, we question the materiality of the “counterparty channel” in the present-day financial system, which is held to much higher levels of resilience.

Regarding the position liquidation channel, the risk of leveraged entities needing to liquidate positions under stress is linked to liquidity preparedness in NBFIs, covered in separate FSB recommendations commented on by ISDA (hereafter referred to as the ISDA NBFI liquidity preparedness response). Our response suggests improving liquidity preparedness in NBFI through improved margin transparency by CCPs, collateral efficiency and availability, and access to resilient repo markets. Addressing these issues can mitigate the risks arising from the “position liquidation channel”.

Interlinkages with systemically important financial institutions

In discussing interlinkages between NBFIs and systemically important financial institutions, the FSB refers to the Archegos collapse and the commodities market stress (referring specifically to the nickel market events), noting that these events illustrate how “the default or distress of a non-bank entity can propagate stress to its counterparties”.

On this, we would note that interlinkages between non-banks and systemically important financial institutions should also be considered as a feature of well-functioning and integrated financial markets, that enable market participants to price and transfer risk and access the liquidity that they need at all times, provided such exposures are appropriately managed.

Also, as noted in the ISDA NBFI liquidity preparedness response, the failure of Archegos was a very idiosyncratic incident. At the time, Archegos was not required to report its transactions or post margin for securities-based swaps as SEC regulations regarding the treatment of such transactions had not yet been implemented. Current rules now mandate that even family offices like Archegos must report transactions and adhere to the SEC’s margining regime.

Such reporting would have allowed regulators to detect the build-up of risky positions. For example, an ESMA report showed that EMIR data could track Archegos' increasing exposures in early 2021, helping monitor leverage and concentration risk. The case was

also not just an example of poorly managed leverage, but also involved a very idiosyncratic fraud case. Incremental improvements to bank counterparty credit risk management have also been implemented following the Archegos event, further to regulatory guidance.

These improvements have also been recognised in comments from the Federal Reserve Board's Vice Chair for supervision, Michael Barr, who noted that "[b]anks have made important progress since the failure of Archegos to improve counterparty credit risk management practices because of their own reflection on the lessons learned from Archegos and in response to supervisory input. For instance, banks have improved information disclosures from clients, adopted risk-sensitive margin practices to a greater extent, and enhanced tools to manage risk."

Regarding the nickel market events, while leverage was a factor, it is important to note that the primary cause of stress was not leverage itself, but rather an episode of unprecedented price volatility and constraints on physical delivery options to cover short positions. This, along with exchange controls failing, led the London Metal Exchange (LME) to suspend nickel trading and cancel trades, as detailed in the FSB report on the financial stability aspects of commodities markets. With such price swings, any amount of leverage would expose market participants to potential significant losses,indicating that constraining leverage may not be the most effective solution. Instead, the use of leverage by countercyclical investors could allow them to enter markets with such imbalances, helping to restore liquidity and return the market to its equilibrium.

In summary, we advise against using the specific events of the LME nickel crisis to argue for broad leverage constraints, or as evidence of widespread commodity market instability. Analyses, like the FSB report on the financial stability aspects of commodities markets, do not indicate systemic risk during the energy crisis. The FSB found that, despite price volatility, increased margin calls, and increased liquidity demand, commodity markets (other than the LME nickel market crisis, which we have explained was specific in nature) remained resilient through the 2020 and 2022 shocks, markets continued to function and there was little impact on the rest of the financial system. Furthermore, areas of concern, such as margin procyclicality and NBFI liquidity preparedness are already being addressed by other international workstreams.

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?

Before discussing the individual risk metrics described in the report, we would emphasize that the priority for authorities should be to better use the information they currently have through existing reporting requirements, and develop a system-wide perspective leveraging existing data, rather than adding in new data requirements on market participants. Any new reporting requirement should only be implemented following a thorough review of the information that is already being collected. Information should be collected from the relevant entity directly, rather than from intermediaries, where possible.

We note that under Recommendation 1, the FSB suggests that authorities should include metrics that "best capture the most relevant dimensions of NBFI leverage vulnerabilities". The dimensions defined by the FSB include leverage, collateralisation, margins and liquidity risks related to leverage, sensitivity to market risk, and concentration risk. We note that the leverage metrics detailed in Annex 1 include "gross leverage" measures.

Leverage metrics

We question the effectiveness of gross leverage metrics, from a risk monitoring perspective. This applies whether it is for monitoring leverage in the NBFI sector, as discussed in the FSB report, in the banking sector (such as in the complexity indicator of the GSIB framework), or in the context of derivatives regulation more broadly, as discussed in an ISDA Research Note. According to the FSB framework of analysis, risks arising from leverage would materialize through the "counterparty channel" or the "position liquidation channel". Therefore, any metric proposed for inclusion in authorities' monitoring toolkits should relate to these channels of transmission.

With that in mind, we urge caution when using gross measures, especially the "gross synthetic leverage" measure, defined as the ratio of the absolute sum of gross notional amounts of the entity's derivatives positions to its capital or NAV. Gross notional is a poor proxy for risk, be it for banks or non-banks. This is acknowledged, for example, in a Bank of England Quarterly Bulletin on OTC derivatives, central clearing and financial stability, which notes that "the notional value is a measure of activity but not necessarily of economic exposure or of risk". Looking at gross notional amounts of derivatives at the level of an entity, or the system, does not take into account how the derivative transactions are used. For example, some positions might be offsetting each other (positions of a market maker would look very leveraged under a gross measure but would be much more moderate once netting is taken into consideration), or derivatives may be used as hedges, which reduce rather than amplify risks. Spread trades are another example illustrating why gross notional is not a good measure for risk: as noted in the FSB report on incentives to centrally clear OTC derivatives, "as spread trades typically depend on the difference between two quantities rather than an absolute level, they are often less risky than an outright trade of the same size". Because the notional metric is not representative of risk, it is also a poor indicator of what the potential margin requirements may be under stress, which is the key issue to consider when assessing the materiality of the "position liquidation channel".

While the FSB's proposals relate to monitoring leverage in the NBFI sector, we would also encourage standard setters and authorities to revisit the use of gross notional measures in the prudential framework for banks and other entities that are subject to prudential requirements.

Collateralisation, margins and liquidity risks related to leverage

The haircut ratio is defined as capturing "the market value of pledged collateral to total repo borrowings". We would caution against using this metric as a way to impose haircuts on repo collateral, for the reason we set out when discussing minimum haircuts in response to the questions under Recommendation 5. We would also highlight that as a blunt metric, it is open for

misinterpretation as it does not reflect the market dynamics and types of collateral.

The ratio of initial margins to cash (or highly liquid assets) is meant to capture "the ability of the entity to meet margin calls on its derivative exposures by using unencumbered cash". However, the initial margins number in this ratio include IM that is already posted. While the amount of IM posted can be interpreted as a proxy for market moves under stress, which might lead to large VM calls, it can be discussed how comparing this number to the available amount of cash of highly liquid assets provides any information or liquidity risks related to leverage. The ratio does not provide any indication on the entity's ability to meet increased IM calls in times of stress, as it is based on the current level of IM posted. Instead of a

simplifying ratio based on the current level of IM posted, we would suggest to encourage greater transparency from CCPs on their IM methodologies as the most appropriate way to estimate and anticipate potential IM increases under stress.

The roll-over risk ratio is expressed as the ratio of maturing borrowing to available liquidity or financing liquidity. This could force firms to increase what the FSB describes as "available liquidity or financing liquidity". As noted in our response to the FSB consultation on liquidity preparedness in NBFI, we would caution again adopting measures that would result in inappropriately over-insuring against liquidity risk and trapping too much cash, thus rendering it unavailable for use or investment in the real economy. Supervising entities against such a ratio could result in requiring entities to maintain excessive cash buffers or to secure expensive long-term funding arrangements. For non-banks, the ability to hold large positions in cash may be significantly constrained by operational limitations or regulatory requirements, depending on their business model and investment strategies. The options that NBFIs (and other non-financial market participants) have in terms of holding cash are either to use a commercial bank account, which has operational and credit risk implications, through increased risk exposure to commercial banks, or to invest the cash in money market funds (MMFs), which can increase liquidity constraints when cash is required and the MMF shares need to be liquidated. In turn, transforming assets into cash depends on banks' ability to intermediate. Therefore, rather than monitoring individual entities against a roll-over risk metric, the focus should be placed on ensuring that market participants have access to deep and liquid markets to repo or sell assets in.

Concentration risk and crowdedness metrics

The set of metrics contemplated by the FSB aims to cover risks from concentration and crowdedness on a system-wide level. We would encourage the use by authorities of existing data collections to develop a system-wide perspective, that can fit into system-wide analyses. Authorities are best placed to develop such a system-wide view through the data that they collect, and the publication of thematic analyses on market developments can help inform market participants' risk management practices, as was done by the Bank of England with the publication of its system wide exploratory scenario exercise, and by ESMA when looking ex-post at the Archegos case. However, we would caution against using these measures to impose concentration-related measures at entity-level, for reasons set out in response to Question 7.

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

There is no single metric that is most effective for monitoring system-wide financial stability risks arising from these factors. However, a complementary set of metrics, as proposed by the FSB, could be used to build a holistic picture of where risk may be building within the market. Authorities should consider all the data that they already collect from market participants from a system-wide perspective and how this data can be better used to develop a holistic view of the market. This should not require introducing any additional reporting requirements at entity-level. This would allow authorities to identify concentration and crowdedness, in a way that is harder for any individual financial institution to do with its own view of the market. By publishing the result of such analyses, authorities would provide

valuable information to market participants, who can then factor this into their risk management.

(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?**

It is important to consider the costs and benefits of enhancing public disclosures. While transparency can be beneficial in some situations, in other cases, the application of public disclosure requirements can have negative impacts, including a possible reduction in participation and overall market liquidity and consideration of mitigations such as aggregation, anonymisation, publication delays etc., as acknowledged in the FSB consultation report. We think that a mix of disclosures to regulators and private disclosures to counterparties should remain the preferred option with respect to possible concerns in relation to leverage risks. Any form of public disclosures should be subject to a stringent cost-benefit analysis, including an analysis of the impact of such measures on market liquidity, and only conducted in markets where the cited benefits truly outweigh possible negative side effects, as mentioned below. In this context, please also note our commentary in relation to Recommendation 9 on the need for regulators to use and share already available data on derivatives exposures at trade repositories.

It is not clear, contrary to what the FSB consultation report may suggest, that the cited benefits in the FSB report of supporting monitoring of concentrations, crowdedness and less liquid conditions can outweigh the costs if they are not subject to suitable mitigants. Public disclosures of aggregate positioning and market liquidity could expose market participants to undue risk, especially in concentrated markets. Therefore, any public disclosures should only be made where they enhance risk managers' understanding of risks while strictly ensuring that public disclosures cannot lead to reverse engineering of entities' positions, which may more likely occur in less liquid and

concentrated markets. In principle, any of such disclosures should be subject to appropriately calibrated frequency and not be too granular.

Our concerns with respect to public disclosures are even more relevant with respect to the

dissemination of non-anonymous data, widely agreeing with the arguments raised in the FSB consultation report itself, such as a possible reduction in participation and market liquidity due to triggering crowdedness, exposing market participants to undue risk and regulatory arbitrage strategies to avoid thresholds. For example, a fund may use a CDS to hedge credit risk to a bond issuer. The dealer would require time to trade out of the risk. Public disclosure of CDS positions prior to hedging may then expose the dealer to undue risk as opportunistic market participants could front run the dealer's hedging need. This

would need to be priced in, leading to higher prices, lower liquidity or exiting of markets. Any disclosures should not expose market participants to such undue risk. Hence, data disclosures should not relate to specific entities, should be sufficiently aggregated and publication should be delayed, with appropriate caps and masking for large trades (e.g., on volume and price).

Furthermore, we share concerns with respect to confidentiality of non-anonymous data and certain aggregated data which could be subject to reverse engineering. There are legitimate reasons for market participants' preference to hold certain positions without these positions being subject to public transparency, and disclosures would need to be aligned with confidentiality agreements.

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?**

   We caution against imposing additional entity- or activity- based measures, as discussed further down in our response. Instead, we would encourage authorities to focus on monitoring system-wide dynamics, and communicating their findings to the markets in a way that market participants can then factor into their own risk management. We would emphasize that the priority for authorities should be to better use the information they currently have access to through existing reporting requirements, rather than adding in new data requirements on market participants.

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?**

   Minimum haircuts in SFTs, including government bond repos

   First, no major jurisdiction has implemented the BCBS minimum haircut requirements. In relation to the US Basel III implementation, as noted in the ISDA-SIFMA comment letter to the US Basel III Notice of Proposed Rulemaking, jurisdictions such "as Canada, the EU, Japan and the UK have not implemented minimum haircut floors. With respect to the EU, the EBA in particular has referenced a number of concerns regarding potential implementation of the minimum haircut floor framework, including with respect to (i) the overall scope of institutions and transactions that would be subject to the framework, (ii) the effects of the framework on important financial markets, such as securities borrowing transactions, (iii) the anomalous results that may occur from applying the proposed minimum haircut floor formulae, and (iv) the application of the framework in the context of netting sets. Accordingly, the EBA noted it "believes a cautious approach is warranted before proceeding with the implementation in the EU of the minimum haircut floors framework in the capital framework as designed in the Basel standards" and "[c]onsequently, the EBA recommends at this stage to withhold the implementation in the EU of the minimum haircut floors

framework for SFTs in the capital framework as designed in the Basel III post-crisis reforms standards."" .Following this, the Vice Chair for Supervision indicated in his speech on September 10, 2024 that the minimum haircut requirement would not be implemented. The fact that no major jurisdiction has implemented the minimum haircut requirements reflects the concerns that such a blunt tool would have significant unintended consequences on the SFT market.

Second, we note that a minimum haircut requirement might exacerbate rather than mitigate some of the financial stability risks the FSB is trying to address. As set out in the report and discussed above in our response, the key transmission channel from risks arising from leverage is the "position

liquidation channel", which materialises when market participants face sudden liquidity demands in time of stress or take losses in times of stress, prompting sudden deleveraging and "dash-for-cash" dynamics. Deep and liquid repo markets are critical to ensure that market participants are able to access the liquidity that they need at all times, and, as such, mitigate the risks that may arise from the "position liquidation channel". However, introducing minimum haircuts would result in an increase in cost for a business that provides the means to exchange funds in a low risk and secured manner, and would have detrimental impacts on repo market liquidity. It might also further exacerbate dash-for-cash dynamics in that in times of stress, more collateral will be the needed to source liquidity.

Third, we question what the precise scope of SFTs is in the context of this FSB report. For example, in the EU context, SFTs include a broad swath of transactions, including transactions such as repos, securities or commodities borrowing/lending, amongst others. The term "SFT" is not defined in the FSB report. ISDA would caution against defining SFT as widely as the EU has done, as this could lead to unintended consequences and inappropriate application to a very broad range of transactions, many of which are not the intended focus of the FSB's recommendations.

Further, as the FSB notes, the use of certain activity-based measures, including SFT minimum haircuts, could have a detrimental impact on the cost of hedging and adverse effects on market liquidity, particularly when netting and/or cross-margining arrangements are not appropriately reflected. In this regard, it is notable that the FSB's report suggests that authorities should "consider implementing minimum haircuts in SFTs, including government bond repos". In contrast, government bond repos were specifically excluded from the FSB's 2015 SFT minimum haircuts framework23.

Including government securities would significantly expand the scope of the minimum haircuts framework and further exacerbate the concerns highlighted above.

Finally, the imposition of margin requirements on SFTs and eligible collateral requirements akin to those for derivative transactions may have the effect of rendering those SFTs ineffective for collateral transformation purposes and themselves become a drain on liquid eligible collateral.

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

Mandatory clearing of certain liquid and standardised derivatives transactions and margin requirements for non-centrally cleared derivatives transactions were cornerstone policies

following the 2008 financial crisis, have been implemented across the globe and have been widely

acknowledged to make the system safter. Instead of looking into further enhancing margin requirements, we would suggest focusing on implementing the policy proposals coming out of the recent global work on margin practices.

Margin practices in centrally cleared markets have been undergoing an in-depth review by the BCBS-CPMI-IOSCO's recent reports, and final policy proposals were published in January 2025. As highlighted by BCBS-CPMI-IOSCO, transparency in CCP margining practices is a critically important aspect to enable market participants to better prepare for and anticipate potential margin calls in centrally cleared markets. Increasing transparency in CCP margining practices will serve to increase the accuracy and robustness of liquidity risk management at NBFIs. ISDA expressed support for the proposals on CCP transparency in its response to the BCBS-CPMI-IOSCO consultation. Relatedly, as also noted in ISDA's response to the BCBS-CPMI-IOSCO consultation, further work on the calibration of anti-procyclicality tools would be welcome.

As regards margin practices in non-centrally cleared markets, non-centrally cleared trades executed in bilateral markets are governed by a robust regulatory framework, with prescriptive margin and regulatory reporting requirements. Increased margin requirements in non-centrally cleared markets would appear superfluous as counterparties already do risk assessments on top of the minimum uncleared margin requirements, or they can add higher haircuts as an option as well. The BCBS-IOSCO report on streamlining variation margin processes and initial margin responsiveness of margin models in non-centrally cleared markets published in January 2025 did not recommend any revisions to the WGMR Framework.

We noted the following observations in the report: "ISDA SIMM used in non-centrally cleared markets relies on representative trading volumes for broad categorisations of risk exposures when calibrating incremental margin requirements for concentration risk, meaning it may not fully capture the idiosyncratic risks of specific concentrated risk exposures. More generally, these requirements are typically calibrated to mitigate counterparty credit risk and therefore may not fully capture the financial stability risks of procyclical deleveraging".

We would like to highlight that, under the Margin requirements for non-centrally cleared derivatives ("Margin Rules"), variation and initial margin offer enhanced protection against counterparty credit risk, and SIMM has been designed in line with the Margin Rules to calculate regulatory initial margin. The Margin Rules have the specific requirement to include stress data in an initial margin model to create a more stable margin and mitigate procyclical changes in the initial margin amount required.

Central clearing of repos

We are aware that the FSB NBFI work programme, as described in the FSB 2024 work programme, refers to "conducting new work on the functioning and resilience of repo markets". The FSB published a comprehensive analysis of core funding markets in 2022, notably including an analysis of the costs and benefits of central clearing. In addition, the US authorities have mandated increased reporting and clearing of both cash Treasury and repo markets. Monitoring the implementation of these new rules may provide useful information to the FSB when determining the usefulness of repo clearing in this market, and to identify potential issues before embarking on this path. This is a highly complex

implementation project, and it is not yet clear the implications that mandatory clearing of government bond repo will have for market liquidity, spreads, or investors. For instance, it is not clear yet whether access models can be developed that enable repo clearing at affordable cost for all clients. In addition, key features of repo markets differ across jurisdictions, and the approach followed in the US might not be suitable elsewhere.

It is also important to highlight that creating capacity for banks to support and engage in clearing activity is important. An important cost for banks to engage in this activity is capital requirements and therefore it is crucial to calibrate them appropriately to ensure that banks support in this activity is not disincentivised.

Central clearing of derivatives

Central clearing mandates of standardised OTC interest rate swap products and certain credit derivatives are now well embedded in G20 jurisdictions. As shown by recent episodes of market stress, a key focus of policy work at the moment is to address unintended consequences from more widespread central clearing: with BCBS-CPMI-IOSCO looking at cleared margin procyclicality and transparency in CCP margin practices, and CPMI-IOSCO looking at VM practices. Episodes such as the dash-for-cash have illustrated how cash demands arising from cleared margin calls can act as a liquidity risk transmission channel in times of stress. Therefore, bringing more products into central clearing would only serve to exacerbate the "position liquidation channel".

In addition, we emphasise that some products are simply not suitable for central clearing: products with insufficient volume or liquidity, or that are insufficiently standardised. If such products were subject to mandatory clearing, in the event of a default of a market participant, the liquidation of such positions would likely result in substantial mutualised losses impacting non-defaulting market participants, amplifying rather than mitigating the consequences of an idiosyncratic default event.

Finally, non-cleared margin requirements have been well-developed after the Great Financial Crisis and give market participants an opportunity to transact in more liquid and customizable markets when liquidity on venues and CCPs drops. Bilateral contracts often allow for a broader range of collateral for non-centrally cleared VM, compared to cleared VM where only cash is allowed. This is a valuable feature, that reduces pressure on firms' need to obtain cash and increases the stability of commodity markets. In addition, bilateral OTC transactions have a higher degree of visibility and predictability of margin requirements, as compared to those under the centrally cleared markets given the current28 lack of transparency of CCP margin models. This flexibility, transparency and predictability are important considerations, particularly for end-users and other non-financial market participants who may not have as much ready access to cash to fund margin calls as banks and in this way may mitigate risks of widespread selling of non-cash assets for such calls. The flexibility to enter into bilateral transactions plays a vital role for market participants' investment and risk management.

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?**

Response to Question 7 and 8

We caution against dynamic approaches to minimum margin and haircut requirements, which are bound to have procyclical effects and could come with significant unintended consequences on market liquidity and cost of hedging.

(We note that when discussing concentration-related measures, the FSB considers the application of concentration add-ons for haircuts and margins in SFT and derivatives markets, because "these requirements are typically calibrated to mitigate counterparty credit risk and therefore may not fully capture the financial stability risks of procyclical deleveraging". As acknowledged by the FSB, these requirements address counterparty credit risk, and therefore mitigate the transmission of risks from leverage through the "counterparty channel". Procyclical deleveraging is problematic when dash-for-cash dynamics develop, leading to transmissions of risks through the "position liquidation channel", and we have suggested options that should be explored to address this risk, that is through: enhanced transparency from CCPs on their margin practices to help with liquidity preparedness and anticipation, easing the pressures arising from collateral demands (we suggest avenues to consider in that regard in our response to the FSB recommendations on liquidity preparedness in NBFI for margin and collateral calls), and ensuring that market participants have access to deep and liquid repo markets at all times. Following those paths will address the risks that the FSB is seeking to address here (i.e. procyclical deleveraging) more adequately than imposing concentration add-ons at entity-level.

In addition, a framework where authorities have the power to issue directions to adjust minimum margin and haircut requirements would add uncertainty in stress circumstances. Under a discretionary policy framework, regulators should be extremely careful when exercising such powers, as market participants will attempt to anticipate what authorities may or may not do with these powers, while authorities will be attempting to anticipate how the market would react to discretionary measures. This may result in herd behaviours or negative feedback loops – either in reaction to an intervention, or in anticipation of a potential measure – which could amplify the stress. A broad sweeping discretionary measure, affecting a whole market, would also inevitably come with unintended consequences on some market participants, which cannot reasonably assume the cumulative effect of various discretionary powers triggered by different authorities, in a potentially uncoordinated fashion. Managing dynamic haircuts would also create operational challenges, resulting in an increase in disputes and potentially additional counterparty risk.

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

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

As noted in response to question 6, we have several concerns with the suggestions in the report with regards to margin requirements and minimum haircuts for SFTs.

More specifically, we question what the precise scope of SFTs is in the context of this FSB report. In the EU context, SFTs include a broad swath of transactions, including transactions such as repos, securities or commodities borrowing/lending, amongst other. The term "SFT" is not defined in the FSB report and we would caution against defining the scope of such transactions as broadly as in the EU.

We also caution against introducing minimum haircuts requirements, as such a measure might exacerbate rather than mitigate some of the financial stability risks the FSB is trying to address. As set out in the report and discussed above in our response, the key transmission channel from risks arising from leverage is the "position liquidation channel", which often materialises when market participants face sudden liquidity demands in time of stress or take losses in times of stress, prompting sudden deleveraging and "dash-for-cash" dynamics. Deep and liquid repo markets are critical to ensure that market participants can access the liquidity that they need at all times, and, as such, mitigate the risks that may arise from the "position liquidation channel". However, introducing minimum haircuts would result in an increase in cost for a business that provides the means to exchange funds in a low risk and secured manner with detrimental impacts on repo market liquidity. It might also further exacerbate dash-for-cash dynamics in that in times of stress, more collateral will be the needed to source liquidity.

In addition, the imposition of margin requirements on SFTs and eligible collateral requirements akin to those for derivative transactions may have the effect of rendering those SFTs ineffective for collateral transformation purposes and themselves become a drain on liquid/ eligible collateral. We also note that SFTs are, by nature, already collateralised transactions.

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?

As noted above, the report does not define what such core financial markets are. The term "core financial markets" is then used throughout the report, including in Recommendation 1, but the precise scope of which markets are covered remains unclear. The report, on page 21, suggests that such core financial markets would include government bond cash and repo markets, or real estate investment markets, but the precise scope is not defined. We would encourage the FSB to further define on which markets leverage may create such financial stability risks, and which are the financial markets deemed as core to the financial system. The concept of "core financial markets" should exclude commodity markets as these operate fundamentally differently and serve a different purpose compared to other financial markets which may be deemed as "core financial markets", such as bond and repo markets.

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?

Addressing the financial stability risks from NBFI leverage largely relies on mitigating the transmission of risks through the "position liquidation channel". This primarily hinges on ensuring that market participants can access deep and liquid repo markets to raise liquidity in times of stress, while also exploring ways to ease the pressure arising from collateral demands for NBFIs. Making progress on both dimensions would significantly address the financial stability risks that the FSB discusses in this paper. This should be the focus of any future policy development, rather than imposing entity-based measures on market participants that are not individually systemic. Individual entity-based measures would also come with significant unintended consequences, as discussed in response to Question 12.

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

    First, the FSB should consider existing regulations that address transparency, concentration risk, and liquidity preparedness, and how limits or additional measures such as the ones contemplated in the report could conflict or be redundant with those existing regulations. For example, NBFIs who trade derivatives in any significant size or hold themselves out as liquidity providers or market makers would already be subject to mandatory IM requirements when trading with similar entities or banks.

    In addition, commodity firms are subject to position and aggregation limits set by the relevant exchanges or regulators such as the CFTC in the US, or in the EU, under MIFID II.

    Second, entity-based measures would place restrictions on metrics that are not adequate indicators of risk, and might constrain the ability of market participant to hedge, provide liquidity, restore market equilibrium.

    For example, the Bank of England's System Wide Exploratory Scenario exercise identified that the inability to access repo financing in times of stress, might delay the entry of countercyclical investors looking to take advantage of falling prices. However, their entry – conditioned on their ability to access the financing that they need – would have stabilised the markets. Therefore, placing entity-based measures could have unintended consequences on the ability of certain NBFI to act as countercyclical investors and liquidity providers, and stabilise markets, in a stress scenario.

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?**

    Rather than complementing each other, we see a risk that the far-reaching measures contemplated in the report, at activity- and entity-level, are likely to produce unintended consequences, more likely to exacerbate the risks of procyclical deleveraging and accentuating the risks from the "position liquidation channel". For example, dynamic haircuts on SFTs combined with entity-level limits on leverage might stifle NBFI's ability to raise liquidity in times of stress, which might precipitate a default on a margin payment, or delay the entry of countercyclical NBFI investors (as explained in response to Question 12).

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?**

    As acknowledged in the report, the BCBS recently consulted on and finalised guidelines for counterparty credit risk management. In doing so, the BCBS engaged with industry, including with ISDA/IIF, to produce a robust set of a practical guidelines. Instead of considering further enhancement to counterparty credit risk management, we would encourage the implementation of the BCBS Guidelines on credit counterparty risk management at this time. In particular, we supported the BCBS objective that banks and supervisors take a "risk-based and proportional approach in the application of the guidelines". We agree on the Recommendation 6 itself, i.e. "ensure the timely and thorough

implementation of the BCBS's guidelines on counterparty credit risk". We believe such an approach would largely address the perceived financial stability risks from NBFI leverage.

We also reiterate the point made in response to previous questions that the term "core financial markets" is then used throughout the report, but the precise scope of which markets are covered remains unclear. We would encourage the FSB to further define on which markets leverage may create such financial stability risks, and which are the financial markets deemed as core to the financial system.

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?

Response to Question 15 and 16

We note that any expectation for a minimum set of private disclosures should make it clear that in some cases, a counterparty might have a justifiable reason for not disclosing certain information. Any set of minimum standards would need to have appropriate carve outs to account for legitimate reasons why a counterparty may not be able to disclose. It is also worth noting that the final BCBS credit counterparty risk guidelines explicitly acknowledged that "[i]n establishing a disclosure framework, banks may also need to recognise that, in certain cases, there may be constraints on publicly listed counterparties in terms of the information they can provide that is not publicly available."

We welcome the suggestion by the FSB 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". As noted in our response to the BCBS Guidelines on credit counterparty risk management, banks should have the flexibility to adapt their approach based on specific circumstances and the requirements of each client, while still maintaining the appropriate due diligence and risk management practices. It is possible that some clients may be constrained from providing the disclosures mentioned in the guidelines, while others reasonably may regard the bank's request as excessive or inappropriate considering the type or stature of the client, or the nature of the intended commercial relationship between the parties.

We note that Recommendation 7 considers the situation where clients use multiple leverage providers. Relatedly, we would emphasise that maintaining several active commercial relationships with different leverage providers builds in additional resilience rather than risk, as it reduces the reliance on critical nodes. For example, a client that clears through multiple clearing members is less reliant on any single clearing member, such that it would be less impacted in the event of a clearing member default, and might be able to port its positions more easily, as discussed in the ISDA whitepaper on "Addressing Porting Challenges".

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?

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?**

    Harmonised data and metrics may not be appropriate for all counterparties or types of client relationship. We would caution against using the metrics defined under Recommendation and the Annex, as suggested under Recommendation 7, as we have outlined in response to Question 2 the concerns that we have with the proposed metrics.

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?**

    We question how broadly defined the term “leverage provider” is. Given that the FSB’s report considers many activities as leverage-inducing, such as entering into derivatives transactions, the term could refer to any derivative counterparty.

    Before considering enhancing disclosures in times of stress, the FSB would need to consider what information is already publicly available, and the various constraints that apply to public companies with regards to financial disclosures. We would encourage leaving it up to individual firms to decide how to handle information disclosure in stress episodes, a practice which is already happening today and does not require further regulatory guidance.

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?**

    A significant amount of work has been and is being done to continuously improve counterparty risk management, including disclosures. As noted above, it is important that disclosures: (1) be proportionate, using a risk-based approach that incorporates the nature, scale and complexity of the risks that a given counterparty poses to its leverage provider, (2) be adaptable, and provide flexibility for leverage providers, based on specific circumstances and the requirements of their individual counterparties, while still maintaining the appropriate due diligence and risk management practices and (3) take into consideration the legal, regulatory and market issues affecting counterparties' ability to disclose information.

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?**

    The FSB recommends that authorities should “identify incongruences in the regulatory treatment of NBFI leverage resulting from similar exposures, financial instruments or structures”, adopting the principle of “same risk, same regulatory treatment”. We see a risk of over-simplification in some instances. It also increases the likelihood of inappropriate

application of requirements by authorities and consequent unintended adverse consequences for market stability and the real economy.

Different types of entities conduct similar activities for different purposes and with different risk profiles. Superficially, risks may appear the same, but this is not the case when viewed holistically.

The principle should be used in conjunction with the principle of proportionality, as well as through a holistic view of an entities' activities and risks, rather than a silo-ed view of an individual activity and entity may perform.

For example, the FSB refers to how "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". We have several comments on this point.

First, a movement of positions from central clearing to bilateral markets for products that are not subject to mandatory clearing, should not be considered as an incongruent treatment of risk.

Non-centrally cleared trades executed in bilateral markets are governed by a robust regulatory framework, with prescriptive margin and regulatory reporting requirements. In addition, the flexibility with regards to collateral posting under bilateral credit support agreements may be a source of strength amidst difficult market conditions. Restrictive categories of eligible collateral and a lack of transparency of CCP margining practices resulting in unpredictability of cleared margin requirements, particularly during periods of extreme market stress, can be a cause of increased liquidity risk, as outlined in the ISDA NBFI liquidity preparedness response.

Second, the FSB refers to shifting between products as a way market participant may seek to take advantage from incongruences in margining. The application of the "same risk, same regulatory principle" in that regard, by looking at strategies on specific products, is likely to result in oversimplifications: looking at trades in isolation fails to recognise that such trades are part of a portfolio. A transaction that may appear to increase exposure in isolation may, in fact, be a hedge resulting from a prudent hedging strategy at the level of a portfolio.

We also strongly disagree with any suggestion of an expansion of the scope of regulatory margin requirements for uncleared OTC derivatives to apply to more NBFI that are non-financial entities (NFEs), either (i) directly, by paring back any exemptions available to them, or (ii) indirectly, by requiring their counterparties to apply regulatory margin requirements to all uncleared OTC derivative transactions with those NFEs. This is particularly important where margin requirements are structured such that they apply to all transactions (even those for hedging purposes) once a NFE is no longer able to qualify for an exemption.

This could disincentivise hedging because of the cost increase due to factors such as restrictive categories of eligible collateral for regulatory margin requirements and increased pressure on liquidity providers/ margin transformation facilities – all having the counterproductive effect of making it more likely that some NFEs will be forced to run with more unhedged exposures. Overall, this would reduce the ability of non-financials to effectively manage their cash flows, especially in times of market stress, increasing the pro-cyclical effect of increased prices of underlyings such as raw materials / commodities and, for example, in the energy industry, jeopardizing security of supply and endangering the

energy transition: an unhedged exposure to e.g. very long-term renewable energy projects where secured revenue stream obligations are often necessary up-front to secure project funding, is just not feasible.

The potential for inappropriate application of the “same risk, same regulatory treatment” principle is concerning, also with respect to commodities market participants. There is a difference between commodity market participants and the broader NBFI population, which the FSB seems to have acknowledged in other reports. These firms have special and unique characteristics linked to physical assets and supply. They play a part in larger energy markets and their stability over periods of volatility – this effort seems to contradict this acknowledgement.

Recommendation 9

[The consultation report does not pose a question]

ISDA would also reiterate its view that most data about derivatives activities and exposures are available to regulators via trade repositories. Data at trade repositories allow for the extraction of relevant metrics such as notional outstanding, market to market valuations, data on sensitivities and other data points relevant from a financial stability perspective. However, those data are often not fully utilised by regulators and not shared between regulators with different responsibilities (prudential, market regulators, insurance regulators and central banks) and not shared across borders. If shared and utilised, such data could significantly enhance regulators’ ability to monitor the build-up of risk exposures by leveraging shared data on risk exposures from counterparties. As of

now, cooperation among authorities, for example in the context of the UK gilt crisis, has been on an ad-hoc basis. Authorities should focus their efforts on streamlining transaction reporting and conducting Memoranda of Understanding on data sharing arrangements and address related legal and operational hurdles.

ISDA Safe, Efficient Markets
Celebrating 40 Years

ISDA's response to the FSB consultation report: "Leverage in Non-Bank Financial Intermediation"[1]

Executive summary

The International Swaps and Derivatives Association (ISDA) welcomes the opportunity to provide comments to the Financial Stability Board's (FSB) consultation report on Leverage in Non-Bank Financial Intermediation (NBFI).

We understand that the FSB's concern set out in this report pertains to the use of leverage in the NBFI sector. We note that a lot has already been achieved, over the past few years, to increase resilience in the financial system. Global standard setters and jurisdictional regulators, together with the industry, have taken several steps to that effect, including through the finalisation of the Basel Committee on Banking Supervision (BCBS) Guidelines on Counterparty Credit Risk Management, policy recommendations from the FSB to enhance non-bank market participants' liquidity preparedness for margin and collateral calls, and reports from BCBS-CPMI-IOSCO on transparency and responsiveness of margin in cleared and uncleared markets. At a jurisdictional level, regulators such as the UK's Prudential Regulation Authority[2], the ECB[3], and the FRB[4] have also issued further guidelines, rules, or supervisory communications. In addition, further reporting and margining requirements have been implemented for certain derivative products, such as the SEC's security-based swaps framework.

ISDA members acknowledge that there may be further improvements that could be made to risk identification and monitoring (Recommendations 1 – 3), cross-border cooperation and coordination (Recommendation 9), and potentially some aspects of the availability of disclosures from non-banks (Recommendation 7). However, we encourage the FSB to consider the significant enhancements that have already been made, as well as the further enhancements that are being implemented, and to give time to assess their effect before moving forward with further entity- or activity-based measures (Recommendations 4 – 5), or further steps to address linkages between NBFIs and banks (Recommendations 6 – 7).

We make the following overarching comments on the FSB's report:

First, it is important to reiterate that due to the diverse nature of the NBFI segment (in terms of business models, risk profiles, market activity etc.), and the fact that many NBFIs and other non-bank market participants are already subject to financial and/or market regulation within their home jurisdictions, through local rules and international standards, overly prescriptive regulatory recommendations could be for a number of reasons inappropriate for all such firms across all geographies and market sectors. It could also lead to inappropriate implementation of regulatory requirements by authorities seeking to bring their regulations in line with such recommendations. Consequently, the imposition of a set of minimum standards applicable to all NBFIs is inappropriate and we would suggest that the FSB clearly states that risk metrics presented by the FSB and set out in more detail in Annex 1 of this Report should be applied in accordance with the principle of

[1] Leverage in Non-bank Financial Intermediation: Consultation report
[2] https://www.bankofengland.co.uk/prudential-regulation/letter/2023/fixed-income-financing-thematic-review
[3] https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.supervisory_guides202310_ccrgovernancemanagement.en.pdf
[4] https://www.federalreserve.gov/supervisionreg/srletters/SR2119.htm

proportionality and that they may not all be applicable or appropriate across all NBFI sectors. We would also welcome a clearer statement that non-financial entities are not in scope of these recommendations. We note the FSB's statement from its Final Report on Liquidity Preparedness for Margin and Collateral Calls[5] that *"… financial authorities do not directly supervise all non-bank market participants and are not expected to do so*" and consider that this is an important point to reiterate in this report.

Second, the ways in which the use of leverage in the NBFI sector would create financial stability risks deserve further examination: we have some initial points regarding the two channels of risk transmission defined by the FSB in the report, "**the counterparty channel**" and the "**position liquidation channel**", which would merit further discussion among standard setters and authorities:

- The **counterparty channel** may not appear as material a conduit of risk in the post-2008 financial system, as greater margining and central clearing and enhanced levels of resilience at the system level, have largely addressed the risk of excessive build-up of counterparty credit risk. The often-cited Archegos case would no longer be possible now that SEC margin rules are in force.
- The **position liquidation channel** – i.e. the risk that certain leveraged entities would need to resort to the sale of less liquid assets to meet margin requirements or sudden deleveraging in times of stress – can, for derivative users, largely be tied back to the FSB recommendations on NBFI liquidity preparedness for margin and collateral calls. As such, most risks that may transmit through this channel would be best addressed by looking at cleared margin transparency, collateral efficiency and availability, flexibility in meeting collateral requirements, and related considerations, such as market participants' ability to rely on deep, liquid repo markets that remain resilient under stress, and the capacity of the banking sector to perform its intermediation function.
- The FSB should also consider the extent of the **trade-off between the two channels**: in that, reforms aimed at addressing the "counterparty channel", through increased collateralisation or enhanced prudential standards, might lead to sudden deleveraging in times of stress and result in more acute pressures through the "position liquidation channel".

Third, the report acknowledges the potential **impact of proposed measures on cost of hedging, market liquidity and liquidity needs in time of stress**. We welcome the FSB's statement that mentions the need *"to balance risk mitigation with avoiding restrictions on beneficial aspects of NBFI leverage"* and would suggest that the FSB undertakes a deeper analysis of the impact of the proposed measures on these aspects. In some cases, the impact of the proposed measures could nullify any of the reduction of the financial stability risk arising from leverage. For example, the adoption of minimum haircuts that dynamically increase in times of stress may result in sudden procyclical deleveraging, and, if not appropriately calibrated to capture portfolio risk offsets could negatively impact market liquidity and investment. Similarly, mandating more derivatives products for clearing might create more risk to the system if those products cannot be appropriately risk managed and liquidated by the CCP in the event of the default of a counterparty, for example if the product is insufficiently liquid or standardised. It would also remove the flexibility for market participants to use bilateral markets and benefits from the wider eligibility criteria available therein,

[5] Liquidity Preparedness for Margin and Collateral Calls: Final report

which helpfully reduces the reliance on cash collateral and the risk of "dash-for-cash" dynamics in times of stress. In addition, the imposition of margin requirements on securities financing transactions (SFTs) and eligible collateral requirements akin to those of certain derivatives transactions may have the effect of rendering those SFTs ineffective for collateral transformation purposes and themselves become a drain on liquid collateral. The breadth of the measures proposed in this report could also trigger unintended consequences if all these measures were to be implemented at the same time. We caution standard setters to implement any measure in a careful fashion and to consult on every step in this process.

Fourth, the FSB should account for how **the use of derivatives and secured financing, which the FSB characterises as leverage-inducing activities, support key functions performed by financial markets, including**: financing, hedging, price discovery, and market stabilisation through countercyclical behaviours. In addition, as acknowledged by the FSB, *"the use of leverage, including in NBFI, may in some cases allow entities to meet short-term cash flow needs without having to engage in asset sales."* The FSB and authorities should therefore consider how the proposed entity-or activity-based measures may negatively affect those functions as part of the required cost benefit analysis to inform the policy development process.

Therefore, instead of immediately imposing entity- or activity-based measures, **we would encourage authorities to first**:

- analyse **system-wide dynamics**. As explained in a recent ISDA whitepaper[6], in the case of derivatives, for instance, much of the information required to see and identify the build-up of exposures and risks is available in the trade repository data that is reported to regulators. By publishing analyses on system-wide dynamics utilising those data, authorities would foster market participants' awareness of risks and vulnerabilities building at the system-level in a constructive manner, allowing market participants to mitigate risks on a self-initiative basis, following the strategy that is most suited to the specifics of their activity. Such an approach is more likely to arrive at a form of equilibrium with regards to the use of leverage in the financial system, in a way that supports the functioning of financial markets;
- address the **remaining risks that may crystallise through the position liquidation channel**, by (i) ensuring that market participants can rely on deep and liquid repo markets, under stress, (ii) easing the pressure arising from collateral demands, to reduce the need for sudden deleveraging, (iii) improving the transparency of CCPs' margining practices to help with liquidity preparedness, and (iv) facilitating bank intermediation capacity, which also supports repo market resilience.

[6] Hidden-in-Plain-Sight-Derivatives-Exposures-Regulatory-Transparency-and-Trade-Repositories.pdf

Questions

Recommendation 1

1. Is the description of the financial stability risks from leverage in NBFI accurate and comprehensive? Are there additional vulnerabilities or risk dimensions related to NBFI leverage that authorities should consider for monitoring purposes?
In our response to this question, we provide feedback not just on Recommendation 1, but also on the sections of the report that discuss NBFI leverage and financial stability risks under Section 2.

Scope

The report sets out how the focus is on leverage *"where it can create financial stability risks"* in Section 2.2, referring to *"financial markets that are at the core of the financial system"*. However, the report does not define what such core financial markets are. The term "core financial markets" is then used throughout the report, including in Recommendation 1, but the precise scope of which markets are covered remains unclear. The report, on page 21, suggests that such core financial markets would include government bond cash and repo markets, or real estate investment markets, but the precise scope is not defined. We would encourage the FSB to further define in which markets leverage may create such financial stability risks, and which financial markets are deemed as core to the financial system. For example, the concept of "core financial markets" should exclude commodity markets as these operate fundamentally differently and serve a different purpose compared to other financial markets which may be deemed as "core financial markets", such as government bond and repo markets.

We would also highlight that many NBFIs are already subject to restrictions on leverage. For example, in the EU, leverage is already captured in several ways. For funds regulated under the Undertakings for Collective Investment in Transferable Securities (UCITS) directive, leverage is capped. For funds regulated under the Alternative Investment Funds Managers (AIFM) directive, in the case of leverage above 300%, a strict enhanced reporting obligation to securities regulators already applies. In addition, national competent authorities can require additional constraints. In all those cases, EU regulated funds such as UCITS and AIFMs cannot therefore build up excessive leverage.

Description of financial stability risks from leverage

In addition, as acknowledged in Section 2.1, leverage, as a technique, is a key feature of a well-functioning financial system. Activities involving leverage support key functions, such as facilitating hedging, providing funding, arbitraging price discrepancies and restoring market equilibria where imbalances build up.

The FSB defines risks to financial stability from leverage in terms of two channels. [7] The **"position liquidation channel"** involves sudden deleveraging and asset sales during stress, while the **"counterparty channel"** spreads financial stress from one counterparty's default to others.

Regarding the counterparty channel, it is important to note that post-2008 reforms have significantly reduced counterparty credit risk in the financial system, through margining and central clearing requirements, as well as through increased resilience levels required from leverage providers. The

[7] The Financial Stability Implications of Leverage in Non-Bank Financial Intermediation

recent publication of the BCBS Guidelines for counterparty credit risk management[8], which ISDA commented on during the consultation[9], further supports banks and supervisory authorities on the management of counterparty credit risk, with a risk-based and proportionate application of the guidelines.

As such, we question the materiality of the "counterparty channel" in the present-day financial system, which is held to much higher levels of resilience.

Regarding the position liquidation channel, the risk of leveraged entities needing to liquidate positions under stress is linked to liquidity preparedness in NBFIs, covered in separate FSB recommendations commented on by ISDA (hereafter referred to as the ISDA NBFI liquidity preparedness response).[10] Our response suggests improving liquidity preparedness in NBFI through improved margin transparency by CCPs, collateral efficiency and availability, and access to resilient repo markets. Addressing these issues can mitigate the risks arising from the "position liquidation channel".

Interlinkages with systemically important financial institutions

In discussing interlinkages between NBFIs and systemically important financial institutions, the FSB refers to the Archegos collapse and the commodities market stress (referring specifically to the nickel market events), noting that these events illustrate how *"the default or distress of a non-bank entity can propagate stress to its counterparties"*.

On this, we would note that interlinkages between non-banks and systemically important financial institutions should also be considered as a feature of well-functioning and integrated financial markets, that enable market participants to price and transfer risk and access the liquidity that they need at all times, provided such exposures are appropriately managed.

Also, as noted in the ISDA NBFI liquidity preparedness response, the failure of Archegos was a very idiosyncratic incident. At the time, Archegos was not required to report its transactions or post margin for securities-based swaps as SEC regulations regarding the treatment of such transactions had not yet been implemented. Current rules now mandate that even family offices like Archegos must report transactions and adhere to the SEC's margining regime.

Such reporting would have allowed regulators to detect the build-up of risky positions. For example, an ESMA report showed that EMIR data could track Archegos' increasing exposures in early 2021, helping monitor leverage and concentration risk.[11] The case was also not just an example of poorly managed leverage, but also involved a very idiosyncratic fraud case. Incremental improvements to

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[8] Final guidelines for counterparty credit risk management
[9] ISDA/IIF response to BCBS CCR Guidelines Consultation
[10] ISDA-response-to-FSB-NBFI-consultation.pdf
[11] ESMA determined in an ex-post analysis of Archegos (available here) that regulatory reporting data it receives under the European Market Infrastructure Regulation (EMIR) made it "possible to track the steep increase in concentrated exposures that [Archegos] undertook in February and March 2021" and that such data can "be used to monitor leverage and concentration risk in derivatives markets". Archegos' counterparties that were based in the EU (and UK) were required to report their trades under EMIR, allowing regulators to build a picture of Archegos' exposures.

bank counterparty credit risk management have also been implemented following the Archegos event, further to regulatory guidance.[12]

These improvements have also been recognised in comments from the Federal Reserve Board's Vice Chair for supervision, Michael Barr, who noted that *"[b]anks have made important progress since the failure of Archegos to improve counterparty credit risk management practices because of their own reflection on the lessons learned from Archegos and in response to supervisory input. For instance, banks have improved information disclosures from clients, adopted risk-sensitive margin practices to a greater extent, and enhanced tools to manage risk."*[13]

Regarding the nickel market events, while leverage was a factor, it is important to note that the primary cause of stress was not leverage itself, but rather an episode of unprecedented price volatility and constraints on physical delivery options to cover short positions. This, along with exchange controls failing, led the London Metal Exchange (LME) to suspend nickel trading and cancel trades, as detailed in the FSB report on the financial stability aspects of commodities markets.[14] With such price swings, any amount of leverage would expose market participants to potential significant losses, indicating that constraining leverage may not be the most effective solution. Instead, the use of leverage by countercyclical investors could allow them to enter markets with such imbalances, helping to restore liquidity and return the market to its equilibrium.

In summary, we advise against using the specific events of the LME nickel crisis to argue for broad leverage constraints, or as evidence of widespread commodity market instability. Analyses, like the FSB report on the financial stability aspects of commodities markets, do not indicate systemic risk during the energy crisis. The FSB found that, despite price volatility, increased margin calls, and increased liquidity demand, commodity markets (other than the LME nickel market crisis, which we have explained was specific in nature) remained resilient through the 2020 and 2022 shocks, markets continued to function and there was little impact on the rest of the financial system. Furthermore, areas of concern, such as margin procyclicality and NBFI liquidity preparedness are already being addressed by other international workstreams.

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[12] See for instance:
www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2021/december/supervisory-review-global-equity-finance-businesses.pdf
https://www.federalreserve.gov/supervisionreg/srletters/SR2119.htm
https://www.federalreserve.gov/newsevents/speech/barr20240227a.htm
https://www.bankingsupervision.europa.eu/press/speeches/date/2024/html/ssm.sp240228~a9397948a8.en.html

[13] Speech by Vice Chair for Supervision Barr on counterparty credit risk - Federal Reserve Board
[14] The Financial Stability Aspects of Commodities Markets: The Financial Stability Aspects of Commodities Markets

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?

Before discussing the individual risk metrics described in the report, we would emphasize that the priority for authorities should be to better use the information they currently have through existing reporting requirements, and develop a system-wide perspective leveraging existing data, rather than adding in new data requirements on market participants. Any new reporting requirement should only be implemented following a thorough review of the information that is already being collected. Information should be collected from the relevant entity directly, rather than from intermediaries, where possible.

We note that under Recommendation 1, the FSB suggests that authorities should include metrics that "best capture the most relevant dimensions of NBFI leverage vulnerabilities". The dimensions defined by the FSB include leverage, collateralisation, margins and liquidity risks related to leverage, sensitivity to market risk, and concentration risk. We note that the leverage metrics detailed in Annex 1 include "gross leverage" measures.

Leverage metrics

We question the effectiveness of gross leverage metrics, from a risk monitoring perspective. This applies whether it is for monitoring leverage in the NBFI sector, as discussed in the FSB report, in the banking sector (such as in the complexity indicator of the GSIB framework), or in the context of derivatives regulation more broadly, as discussed in an ISDA Research Note[15]. According to the FSB framework of analysis, risks arising from leverage would materialize through the "counterparty channel" or the "position liquidation channel". Therefore, any metric proposed for inclusion in authorities' monitoring toolkits should relate to these channels of transmission.

With that in mind, we urge caution when using gross measures, especially the "**gross synthetic leverage**" measure, defined as the ratio of the absolute sum of gross notional amounts of the entity's derivatives positions to its capital or NAV. Gross notional is a poor proxy for risk, be it for banks or non-banks. This is acknowledged, for example, in a Bank of England Quarterly Bulletin on OTC derivatives, central clearing and financial stability, which notes that *"the notional value is a measure of activity but not necessarily of economic exposure or of risk"*. [16] Looking at gross notional amounts of derivatives at the level of an entity, or the system, does not take into account how the derivative transactions are used. For example, some positions might be offsetting each other (positions of a market maker would look very leveraged under a gross measure but would be much more moderate once netting is taken into consideration), or derivatives may be used as hedges, which reduce rather than amplify risks. Spread trades are another example illustrating why gross notional is not a good measure for risk: as noted in the FSB report on incentives to centrally clear OTC derivatives, *"as spread trades typically depend on the difference between two quantities rather than an absolute level, they are often less risky than an outright trade of the same size"*.[17] Because the notional metric is not representative of risk, it is also a poor indicator of what the potential margin requirements may

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[15] Uses of Notional Amounts in Derivatives Regulation, ISDA Research Note (May 2018), available here.
[16] Bank of England Quarterly Bulletin 2015 Q3
[17] Incentives to centrally clear over-the-counter (OTC) derivatives

be under stress, which is the key issue to consider when assessing the materiality of the "position liquidation channel".

While the FSB's proposals relate to monitoring leverage in the NBFI sector, we would also encourage standard setters and authorities to revisit the use of gross notional measures in the prudential framework for banks and other entities that are subject to prudential requirements.

Collateralisation, margins and liquidity risks related to leverage

The **haircut ratio** is defined as capturing "the market value of pledged collateral to total repo borrowings". We would caution against using this metric as a way to impose haircuts on repo collateral, for the reason we set out when discussing minimum haircuts in response to the questions under Recommendation 5. We would also highlight that as a blunt metric, it is open for misinterpretation as it does not reflect the market dynamics and types of collateral.

The **ratio of initial margins to cash** (or highly liquid assets) is meant to capture "the ability of the entity to meet margin calls on its derivative exposures by using unencumbered cash". However, the initial margins number in this ratio include IM that is already posted. While the amount of IM posted can be interpreted as a proxy for market moves under stress, which might lead to large VM calls, it can be discussed how comparing this number to the available amount of cash of highly liquid assets provides any information or liquidity risks related to leverage. The ratio does not provide any indication on the entity's ability to meet increased IM calls in times of stress, as it is based on the current level of IM posted. Instead of a simplifying ratio based on the current level of IM posted, we would suggest to encourage greater transparency from CCPs on their IM methodologies as the most appropriate way to estimate and anticipate potential IM increases under stress.

The **roll-over risk ratio** is expressed as the ratio of maturing borrowing to available liquidity or financing liquidity. This could force firms to increase what the FSB describes as "available liquidity or financing liquidity". As noted in our response to the FSB consultation on liquidity preparedness in NBFI, we would caution again adopting measures that would result in inappropriately over-insuring against liquidity risk and trapping too much cash, thus rendering it unavailable for use or investment in the real economy. Supervising entities against such a ratio could result in requiring entities to maintain excessive cash buffers or to secure expensive long-term funding arrangements. For non-banks, the ability to hold large positions in cash may be significantly constrained by operational limitations or regulatory requirements, depending on their business model and investment strategies. The options that NBFIs (and other non-financial market participants) have in terms of holding cash are either to use a commercial bank account, which has operational and credit risk implications, through increased risk exposure to commercial banks, or to invest the cash in money market funds (MMFs), which can increase liquidity constraints when cash is required and the MMF shares need to be liquidated. In turn, transforming assets into cash depends on banks' ability to intermediate. Therefore, rather than monitoring individual entities against a roll-over risk metric, the focus should be placed on ensuring that market participants have access to deep and liquid markets to repo or sell assets in.

Concentration risk and crowdedness metrics

The set of metrics contemplated by the FSB aims to cover risks from concentration and crowdedness on a system-wide level. We would encourage the use by authorities of existing data collections to

develop a system-wide perspective, that can fit into system-wide analyses. Authorities are best placed to develop such a system-wide view through the data that they collect, and the publication of thematic analyses on market developments can help inform market participants' risk management practices, as was done by the Bank of England with the publication of its system wide exploratory scenario exercise[18], and by ESMA when looking ex-post at the Archegos case[19]. However, we would caution against using these measures to impose concentration-related measures at entity-level, for reasons set out in response to Question 7.

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?

There is no single metric that is most effective for monitoring system-wide financial stability risks arising from these factors. However, a complementary set of metrics, as proposed by the FSB, could be used to build a holistic picture of where risk may be building within the market. Authorities should consider all the data that they already collect from market participants from a system-wide perspective and how this data can be better used to develop a holistic view of the market. This should not require introducing any additional reporting requirements at entity-level. This would allow authorities to identify concentration and crowdedness, in a way that is harder for any individual financial institution to do with its own view of the market. By publishing the result of such analyses, authorities would provide valuable information to market participants, who can then factor this into their risk management.

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?

It is important to consider the costs and benefits of enhancing public disclosures. While transparency can be beneficial in some situations, in other cases, the application of public disclosure requirements can have negative impacts, including a possible reduction in participation and overall market liquidity and consideration of mitigations such as aggregation, anonymisation, publication delays etc., as acknowledged in the FSB consultation report. We think that a mix of disclosures to regulators and private disclosures to counterparties should remain the preferred option with respect to addressing

[18] The Bank of England's system-wide exploratory scenario exercise final report | Bank of England
[19] https://www.esma.europa.eu/sites/default/files/library/esma50-165-2096_leverage_and_derivatives_the_case_of_archegos.pdf

possible concerns in relation to leverage risks. Any form of public disclosures should be subject to a stringent cost-benefit analysis, including an analysis of the impact of such measures on market liquidity, and only conducted in markets where the cited benefits truly outweigh possible negative side effects, as mentioned below. In this context, please also note our commentary in relation to Recommendation 9 on the need for regulators to use and share already available data on derivatives exposures at trade repositories.

It is not clear, contrary to what the FSB consultation report may suggest, that the cited benefits in the FSB report of supporting monitoring of concentrations, crowdedness and less liquid conditions can outweigh the costs if they are not subject to suitable mitigants. Public disclosures of aggregate positioning and market liquidity could expose market participants to undue risk, especially in concentrated markets. Therefore, any public disclosures should only be made where they enhance risk managers' understanding of risks while strictly ensuring that public disclosures cannot lead to reverse engineering of entities' positions, which may more likely occur in less liquid and concentrated markets. In principle, any of such disclosures should be subject to appropriately calibrated frequency and not be too granular.

Our concerns with respect to public disclosures are even more relevant with respect to the dissemination of non-anonymous data, widely agreeing with the arguments raised in the FSB consultation report itself, such as a possible reduction in participation and market liquidity due to triggering crowdedness, exposing market participants to undue risk and regulatory arbitrage strategies to avoid thresholds. For example, a fund may use a CDS to hedge credit risk to a bond issuer. The dealer would require time to trade out of the risk. Public disclosure of CDS positions prior to hedging may then expose the dealer to undue risk as opportunistic market participants could front run the dealer's hedging need. This would need to be priced in, leading to higher prices, lower liquidity or exiting of markets. Any disclosures should not expose market participants to such undue risk. Hence, data disclosures should not relate to specific entities, should be sufficiently aggregated and publication should be delayed, with appropriate caps and masking for large trades (e.g., on volume and price).

Furthermore, we share concerns with respect to confidentiality of non-anonymous data and certain aggregated data which could be subject to reverse engineering. There are legitimate reasons for market participants' preference to hold certain positions without these positions being subject to public transparency, and disclosures would need to be aligned with confidentiality agreements.

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?

We caution against imposing additional entity- or activity- based measures, as discussed further down in our response. Instead, we would encourage authorities to focus on monitoring system-wide dynamics, and communicating their findings to the markets in a way that market participants can then factor into their own risk management. We would emphasize that the priority for authorities

should be to better use the information they currently have access to through existing reporting requirements, rather than adding in new data requirements on market participants.

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?

Minimum haircuts in SFTs, including government bond repos

First, no major jurisdiction has implemented the BCBS minimum haircut requirements. In relation to the US Basel III implementation, as noted in the ISDA-SIFMA comment letter to the US Basel III Notice of Proposed Rulemaking[20], jurisdictions such *"as Canada, the EU, Japan and the UK have not implemented minimum haircut floors. With respect to the EU, the EBA in particular has referenced a number of concerns regarding potential implementation of the minimum haircut floor framework, including with respect to (i) the overall scope of institutions and transactions that would be subject to the framework, (ii) the effects of the framework on important financial markets, such as securities borrowing transactions, (iii) the anomalous results that may occur from applying the proposed minimum haircut floor formulae, and (iv) the application of the framework in the context of netting sets.[21] Accordingly, the EBA noted it "believes a cautious approach is warranted before proceeding with the implementation in the EU of the minimum haircut floors framework in the capital framework as designed in the Basel standards" and "[c]onsequently, the EBA recommends at this stage to withhold the implementation in the EU of the minimum haircut floors framework for SFTs in the capital framework as designed in the Basel III post-crisis reforms standards.""* . Following this, the Vice Chair for Supervision indicated in his speech on September 10, 2024 that the minimum haircut requirement would not be implemented. The fact that no major jurisdiction has implemented the minimum haircut requirements reflects the concerns that such a blunt tool would have significant unintended consequences on the SFT market.

Second, we note that a minimum haircut requirement might exacerbate rather than mitigate some of the financial stability risks the FSB is trying to address. As set out in the report and discussed above in our response, the key transmission channel from risks arising from leverage is the "position liquidation channel", which materialises when market participants face sudden liquidity demands in time of stress or take losses in times of stress, prompting sudden deleveraging and "dash-for-cash" dynamics. Deep and liquid repo markets are critical to ensure that market participants are able to access the liquidity that they need at all times, and, as such, mitigate the risks that may arise from the "position liquidation channel". However, introducing minimum haircuts would result in an increase in cost for a business that provides the means to exchange funds in a low risk and secured manner, and would have detrimental impacts on repo market liquidity. It might also further

[20] ISDA-SIFMA Basel III Endgame Comment Letter, available here
[21] https://www.eba.europa.eu/sites/default/documents/files/documents/10180/2886865/870bbd5e-ae8f-4933-9f36-784c7183c7f4/Policy%20Advice%20on%20Basel%20III%20reforms%20-%20SFTs.pdf

exacerbate dash-for-cash dynamics in that in times of stress, more collateral will be the needed to source liquidity.

Third, we question what the precise scope of SFTs is in the context of this FSB report. For example, in the EU context, SFTs include a broad swath of transactions, including transactions such as repos, securities or commodities borrowing/lending, amongst others[22]. The term "SFT" is not defined in the FSB report. ISDA would caution against defining SFT as widely as the EU has done, as this could lead to unintended consequences and inappropriate application to a very broad range of transactions, many of which are not the intended focus of the FSB's recommendations.

Further, as the FSB notes, the use of certain activity-based measures, including SFT minimum haircuts, could have a detrimental impact on the cost of hedging and adverse effects on market liquidity, particularly when netting and/or cross-margining arrangements are not appropriately reflected. In this regard, it is notable that the FSB's report suggests that authorities should "consider implementing minimum haircuts in SFTs, *including government bond repos*". In contrast, government bond repos were specifically excluded from the FSB's 2015 SFT minimum haircuts framework[23]. Including government securities would significantly expand the scope of the minimum haircuts framework and further exacerbate the concerns highlighted above.

Finally, the imposition of margin requirements on SFTs and eligible collateral requirements akin to those for derivative transactions may have the effect of rendering those SFTs ineffective for collateral transformation purposes and themselves become a drain on liquid eligible collateral.

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

Mandatory clearing of certain liquid and standardised derivatives transactions and margin requirements for non-centrally cleared derivatives transactions were cornerstone policies following the 2008 financial crisis, have been implemented across the globe and have been widely acknowledged to make the system safter.[24] Instead of looking into further enhancing margin requirements, we would suggest focusing on implementing the policy proposals coming out of the recent global work on margin practices.

Margin practices in centrally cleared markets have been undergoing an in-depth review by the BCBS-CPMI-IOSCO's recent reports, and final policy proposals were published in January 2025.[25] As highlighted by BCBS-CPMI-IOSCO, transparency in CCP margining practices is a critically important aspect to enable market participants to better prepare for and anticipate potential margin calls in centrally cleared markets. Increasing transparency in CCP margining practices will serve to increase the accuracy and robustness of liquidity risk management at NBFIs. ISDA expressed support for the proposals on CCP transparency in its response to the BCBS-CPMI-IOSCO consultation. Relatedly, and

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[22] In the Securities Financing Transaction Regulation (SFTR), SFT means "(a) a repurchase transaction; (b) securities or commodities lending and securities or commodities borrowing; (c) a buy-sell back transaction or a sell-buy back transaction; (d) a margin lending transaction" and includes exclusions related to non-funding related transactions, etc.

[23] https://www.fsb.org/uploads/P070920-1.pdf

[24] https://www.bankofengland.co.uk/speech/2024/july/nathanael-benjamin-speech-followed-by-panel-preparing-for-liquidity-stresses

[25] Transparency and responsiveness of initial margin in centrally cleared markets - review and policy proposals

as also noted in ISDA's response to the BCBS-CPMI-IOSCO consultation, further work on the calibration of anti-procyclicality tools would be welcome.

As regards margin practices in non-centrally cleared markets, non-centrally cleared trades executed in bilateral markets are governed by a robust regulatory framework, with prescriptive margin and regulatory reporting requirements. Increased margin requirements in non-centrally cleared markets would appear superfluous as counterparties already do risk assessments on top of the minimum uncleared margin requirements, or they can add higher haircuts as an option as well. The BCBS-IOSCO report on streamlining variation margin processes and initial margin responsiveness of margin models in non-centrally cleared markets published in January 2025 did not recommend any revisions to the WGMR Framework.

We noted the following observations in the report: *"ISDA SIMM used in non-centrally cleared markets relies on representative trading volumes for broad categorisations of risk exposures when calibrating incremental margin requirements for concentration risk, meaning it may not fully capture the idiosyncratic risks of specific concentrated risk exposures. More generally, these requirements are typically calibrated to mitigate counterparty credit risk and therefore may not fully capture the financial stability risks of procyclical deleveraging".*

We would like to highlight that, under the Margin requirements for non-centrally cleared derivatives ("Margin Rules"), variation and initial margin offer enhanced protection against counterparty credit risk, and SIMM has been designed in line with the Margin Rules to calculate regulatory initial margin. The Margin Rules have the specific requirement to include stress data in an initial margin model to create a more stable margin and mitigate procyclical changes in the initial margin amount required.

Central clearing of repos

We are aware that the FSB NBFI work programme, as described in the FSB 2024 work programme[26], refers to *"conducting new work on the functioning and resilience of repo markets"*. The FSB published a comprehensive analysis of core funding markets in 2022[27], notably including an analysis of the costs and benefits of central clearing. In addition, the US authorities have mandated increased reporting and clearing of both cash Treasury and repo markets. Monitoring the implementation of these new rules may provide useful information to the FSB when determining the usefulness of repo clearing in this market, and to identify potential issues before embarking on this path. This is a highly complex implementation project, and it is not yet clear the implications that mandatory clearing of government bond repo will have for market liquidity, spreads, or investors. For instance, it is not clear yet whether access models can be developed that enable repo clearing at affordable cost for all clients. In addition, key features of repo markets differ across jurisdictions, and the approach followed in the US might not be suitable elsewhere.

It is also important to highlight that creating capacity for banks to support and engage in clearing activity is important. An important cost for banks to engage in this activity is capital requirements and therefore it is crucial to calibrate them appropriately to ensure that banks support in this activity is not disincentivised.

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[26] P240124.pdf (fsb.org)
[27] Liquidity in Core Government Bond Markets: Liquidity in Core Government Bond Markets

Central clearing of derivatives

Central clearing mandates of standardised OTC interest rate swap products and certain credit derivatives are now well embedded in G20 jurisdictions. As shown by recent episodes of market stress, a key focus of policy work at the moment is to address unintended consequences from more widespread central clearing: with BCBS-CPMI-IOSCO looking at cleared margin procyclicality and transparency in CCP margin practices, and CPMI-IOSCO looking at VM practices. Episodes such as the dash-for-cash have illustrated how cash demands arising from cleared margin calls can act as a liquidity risk transmission channel in times of stress. Therefore, bringing more products into central clearing would only serve to exacerbate the "position liquidation channel".

In addition, we emphasise that some products are simply not suitable for central clearing: products with insufficient volume or liquidity, or that are insufficiently standardised. If such products were subject to mandatory clearing, in the event of a default of a market participant, the liquidation of such positions would likely result in substantial mutualised losses impacting non-defaulting market participants, amplifying rather than mitigating the consequences of an idiosyncratic default event.

Finally, non-cleared margin requirements have been well-developed after the Great Financial Crisis and give market participants an opportunity to transact in more liquid and customizable markets when liquidity on venues and CCPs drops. Bilateral contracts often allow for a broader range of collateral for non-centrally cleared VM, compared to cleared VM where only cash is allowed. This is a valuable feature, that reduces pressure on firms' need to obtain cash and increases the stability of commodity markets. In addition, bilateral OTC transactions have a higher degree of visibility and predictability of margin requirements, as compared to those under the centrally cleared markets given the current[28] lack of transparency of CCP margin models. This flexibility, transparency and predictability are important considerations, particularly for end-users and other non-financial market participants who may not have as much ready access to cash to fund margin calls as banks and in this way may mitigate risks of widespread selling of non-cash assets for such calls. The flexibility to enter into bilateral transactions plays a vital role for market participants' investment and risk management.

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

Response to Question 7 and 8

We caution against dynamic approaches to minimum margin and haircut requirements, which are bound to have procyclical effects and could come with significant unintended consequences on market liquidity and cost of hedging.

[28] Note that global standard setters (BCBS, CPMI and IOSCO) have made proposals that would significantly improve transparency of CCP margin requirements (Transparency and responsiveness of initial margin in centrally cleared markets - review and policy proposals)

We note that when discussing concentration-related measures, the FSB considers the application of concentration add-ons for haircuts and margins in SFT and derivatives markets, because *"these requirements are typically calibrated to mitigate counterparty credit risk and therefore may not fully capture the financial stability risks of procyclical deleveraging"*. As acknowledged by the FSB, these requirements address counterparty credit risk, and therefore mitigate the transmission of risks from leverage through the "counterparty channel". Procyclical deleveraging is problematic when dash-for-cash dynamics develop, leading to transmissions of risks through the "position liquidation channel", and we have suggested options that should be explored to address this risk, that is through: enhanced transparency from CCPs on their margin practices to help with liquidity preparedness and anticipation, easing the pressures arising from collateral demands (we suggest avenues to consider in that regard in our response to the FSB recommendations on liquidity preparedness in NBFI for margin and collateral calls), and ensuring that market participants have access to deep and liquid repo markets at all times. Following those paths will address the risks that the FSB is seeking to address here (i.e. procyclical deleveraging) more adequately than imposing concentration add-ons at entity-level.

In addition, a framework where authorities have the power to issue directions to adjust minimum margin and haircut requirements would add uncertainty in stress circumstances. Under a discretionary policy framework, regulators should be extremely careful when exercising such powers, as market participants will attempt to anticipate what authorities may or may not do with these powers, while authorities will be attempting to anticipate how the market would react to discretionary measures. This may result in herd behaviours or negative feedback loops – either in reaction to an intervention, or in anticipation of a potential measure – which could amplify the stress. A broad sweeping discretionary measure, affecting a whole market, would also inevitably come with unintended consequences on some market participants, which cannot reasonably assume the cumulative effect of various discretionary powers triggered by different authorities, in a potentially uncoordinated fashion. Managing dynamic haircuts would also create operational challenges, resulting in an increase in disputes and potentially additional counterparty risk.

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

As noted in response to question 6, we have several concerns with the suggestions in the report with regards to margin requirements and minimum haircuts for SFTs.

More specifically, we question what the precise scope of SFTs is in the context of this FSB report. In the EU context, SFTs include a broad swath of transactions, including transactions such as repos, securities or commodities borrowing/lending, amongst other[29]. The term "SFT" is not defined in the

[29] In the Securities Financing Transaction Regulation (SFTR), SFT means "(a) a repurchase transaction; (b) securities or commodities lending and securities or commodities borrowing; (c) a buy-sell back transaction or a sell-buy back transaction; (d) a margin lending transaction" and includes exclusions related to non-funding related transactions, etc.

FSB report and we would caution against defining the scope of such transactions as broadly as in the EU.

We also caution against introducing minimum haircuts requirements, as such a measure might exacerbate rather than mitigate some of the financial stability risks the FSB is trying to address. As set out in the report and discussed above in our response, the key transmission channel from risks arising from leverage is the "position liquidation channel", which often materialises when market participants face sudden liquidity demands in time of stress or take losses in times of stress, prompting sudden deleveraging and "dash-for-cash" dynamics. Deep and liquid repo markets are critical to ensure that market participants can access the liquidity that they need at all times, and, as such, mitigate the risks that may arise from the "position liquidation channel". However, introducing minimum haircuts would result in an increase in cost for a business that provides the means to exchange funds in a low risk and secured manner with detrimental impacts on repo market liquidity. It might also further exacerbate dash-for-cash dynamics in that in times of stress, more collateral will be the needed to source liquidity.

In addition, the imposition of margin requirements on SFTs and eligible collateral requirements akin to those for derivative transactions may have the effect of rendering those SFTs ineffective for collateral transformation purposes and themselves become a drain on liquid/ eligible collateral. We also note that SFTs are, by nature, already collateralised transactions.

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?

As noted above, the report does not define what such core financial markets are. The term "core financial markets" is then used throughout the report, including in Recommendation 1, but the precise scope of which markets are covered remains unclear. The report, on page 21, suggests that such core financial markets would include government bond cash and repo markets, or real estate investment markets, but the precise scope is not defined. We would encourage the FSB to further define on which markets leverage may create such financial stability risks, and which are the financial markets deemed as core to the financial system. The concept of "core financial markets" should exclude commodity markets as these operate fundamentally differently and serve a different purpose compared to other financial markets which may be deemed as "core financial markets", such as bond and repo markets.

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?

Addressing the financial stability risks from NBFI leverage largely relies on mitigating the transmission of risks through the "position liquidation channel". This primarily hinges on ensuring that market participants can access deep and liquid repo markets to raise liquidity in times of stress, while also exploring ways to ease the pressure arising from collateral demands for NBFIs. Making progress on both dimensions would significantly address the financial stability risks that the FSB discusses in this paper. This should be the focus of any future policy development, rather than imposing entity-based

measures on market participants that are not individually systemic. Individual entity-based measures would also come with significant unintended consequences, as discussed in response to Question 12.

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

First, the FSB should consider existing regulations that address transparency, concentration risk, and liquidity preparedness, and how limits or additional measures such as the ones contemplated in the report could conflict or be redundant with those existing regulations. For example, NBFIs who trade derivatives in any significant size or hold themselves out as liquidity providers or market makers would already be subject to mandatory IM requirements when trading with similar entities or banks. In addition, commodity firms are subject to position and aggregation limits set by the relevant exchanges or regulators such as the CFTC in the US, or in the EU, under MIFID II.

Second, entity-based measures would place restrictions on metrics that are not adequate indicators of risk, and might constrain the ability of market participant to hedge, provide liquidity, restore market equilibrium.

For example, the Bank of England's System Wide Exploratory Scenario exercise identified that the inability to access repo financing in times of stress, might delay the entry of countercyclical investors looking to take advantage of falling prices. However, their entry – conditioned on their ability to access the financing that they need – would have stabilised the markets. Therefore, placing entity-based measures could have unintended consequences on the ability of certain NBFI to act as countercyclical investors and liquidity providers, and stabilise markets, in a stress scenario.

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?

Rather than complementing each other, we see a risk that the far-reaching measures contemplated in the report, at activity- and entity-level, are likely to produce unintended consequences, more likely to exacerbate the risks of procyclical deleveraging and accentuating the risks from the "position liquidation channel". For example, dynamic haircuts on SFTs combined with entity-level limits on leverage might stifle NBFI's ability to raise liquidity in times of stress, which might precipitate a default on a margin payment, or delay the entry of countercyclical NBFI investors (as explained in response to Question 12).

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?

As acknowledged in the report, the BCBS recently consulted on and finalised guidelines for counterparty credit risk management. In doing so, the BCBS engaged with industry, including with

ISDA/IIF[30], to produce a robust set of a practical guidelines. Instead of considering further enhancement to counterparty credit risk management, we would encourage the implementation of the BCBS Guidelines on credit counterparty risk management at this time. In particular, we supported the BCBS objective that banks and supervisors take a *"risk-based and proportional approach in the application of the guidelines"*. We agree on the Recommendation 6 itself, i.e. "*ensure the timely and thorough implementation of the BCBS's guidelines on counterparty credit risk*". We believe such an approach would largely address the perceived financial stability risks from NBFI leverage.

We also reiterate the point made in response to previous questions that the term "core financial markets" is then used throughout the report, but the precise scope of which markets are covered remains unclear. We would encourage the FSB to further define on which markets leverage may create such financial stability risks, and which are the financial markets deemed as core to the financial system.

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?

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?

Response to Question 15 and 16

We note that any expectation for a minimum set of private disclosures should make it clear that in some cases, a counterparty might have a justifiable reason for not disclosing certain information. Any set of minimum standards would need to have appropriate carve outs to account for legitimate reasons why a counterparty may not be able to disclose. It is also worth noting that the final BCBS credit counterparty risk guidelines explicitly acknowledged that "*[i]n establishing a disclosure framework, banks may also need to recognise that, in certain cases, there may be constraints on publicly listed counterparties in terms of the information they can provide that is not publicly available.*"

We welcome the suggestion by the FSB 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"*. As noted in our response to the BCBS

[30] ISDA/IIF response to BCBS CCR Guidelines Consultation

Guidelines on credit counterparty risk management, banks should have the flexibility to adapt their approach based on specific circumstances and the requirements of each client, while still maintaining the appropriate due diligence and risk management practices. It is possible that some clients may be constrained from providing the disclosures mentioned in the guidelines, while others reasonably may regard the bank's request as excessive or inappropriate considering the type or stature of the client, or the nature of the intended commercial relationship between the parties.

We note that Recommendation 7 considers the situation where clients use multiple leverage providers. Relatedly, we would emphasise that maintaining several active commercial relationships with different leverage providers builds in additional resilience rather than risk, as it reduces the reliance on critical nodes. For example, a client that clears through multiple clearing members is less reliant on any single clearing member, such that it would be less impacted in the event of a clearing member default, and might be able to port its positions more easily, as discussed in the ISDA whitepaper on "Addressing Porting Challenges"[31].

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?

Harmonised data and metrics may not be appropriate for all counterparties or types of client relationship. We would caution against using the metrics defined under Recommendation and the Annex, as suggested under Recommendation 7, as we have outlined in response to Question 2 the concerns that we have with the proposed metrics.

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?

We question how broadly defined the term "leverage provider" is. Given that the FSB's report considers many activities as leverage-inducing, such as entering into derivatives transactions, the term could refer to any derivative counterparty.

Before considering enhancing disclosures in times of stress, the FSB would need to consider what information is already publicly available, and the various constraints that apply to public companies with regards to financial disclosures. We would encourage leaving it up to individual firms to decide how to handle information disclosure in stress episodes, a practice which is already happening today and does not require further regulatory guidance.

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?

[31] Addressing-Porting-Challenges.pdf

Through regulation, supervisory guidance, and/or via a Code of Conduct or similar approach?

A significant amount of work has been and is being done to continuously improve counterparty risk management, including disclosures. As noted above, it is important that disclosures: (1) be proportionate, using a risk-based approach that incorporates the nature, scale and complexity of the risks that a given counterparty poses to its leverage provider, (2) be adaptable, and provide flexibility for leverage providers, based on specific circumstances and the requirements of their individual counterparties, while still maintaining the appropriate due diligence and risk management practices and (3) take into consideration the legal, regulatory and market issues affecting counterparties' ability to disclose information.

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?

The FSB recommends that authorities should *"identify incongruences in the regulatory treatment of NBFI leverage resulting from similar exposures, financial instruments or structures"*, adopting the principle of *"same risk, same regulatory treatment"*. We see a risk of over-simplification in some instances. It also increases the likelihood of inappropriate application of requirements by authorities and consequent unintended adverse consequences for market stability and the real economy. Different types of entities conduct similar activities for different purposes and with different risk profiles. Superficially, risks may appear the same, but this is not the case when viewed holistically.

The principle should be used in conjunction with the principle of proportionality, as well as through a holistic view of an entities' activities and risks, rather than a silo-ed view of an individual activity and entity may perform.

For example, the FSB refers to how *"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"*. We have several comments on this point.

First, a movement of positions from central clearing to bilateral markets for products that are not subject to mandatory clearing, should not be considered as an incongruent treatment of risk. Non-centrally cleared trades executed in bilateral markets are governed by a robust regulatory framework, with prescriptive margin and regulatory reporting requirements. In addition, the flexibility with regards to collateral posting under bilateral credit support agreements may be a source of strength amidst difficult market conditions. Restrictive categories of eligible collateral and a lack of transparency of CCP margining practices resulting in unpredictability of cleared margin requirements, particularly during periods of extreme market stress, can be a cause of increased liquidity risk, as outlined in the ISDA NBFI liquidity preparedness response.

Second, the FSB refers to shifting between products as a way market participant may seek to take advantage from incongruences in margining. The application of the "same risk, same regulatory principle" in that regard, by looking at strategies on specific products, is likely to result in oversimplifications: looking at trades in isolation fails to recognise that such trades are part of a portfolio. A transaction that may appear to increase exposure in isolation may, in fact, be a hedge resulting from a prudent hedging strategy at the level of a portfolio.

We also strongly disagree with any suggestion of an expansion of the scope of regulatory margin requirements for uncleared OTC derivatives to apply to more NBFI that are non-financial entities (NFEs), either (i) directly, by paring back any exemptions available to them, or (ii) indirectly, by requiring their counterparties to apply regulatory margin requirements to all uncleared OTC derivative transactions with those NFEs. This is particularly important where margin requirements are structured such that they apply to all transactions (even those for hedging purposes) once a NFE is no longer able to qualify for an exemption.

This could disincentivise hedging because of the cost increase due to factors such as restrictive categories of eligible collateral for regulatory margin requirements and increased pressure on liquidity providers/ margin transformation facilities – all having the counterproductive effect of making it more likely that some NFEs will be forced to run with more unhedged exposures. Overall, this would reduce the ability of non-financials to effectively manage their cash flows, especially in times of market stress, increasing the pro-cyclical effect of increased prices of underlyings such as raw materials / commodities and, for example, in the energy industry, jeopardizing security of supply and endangering the energy transition: an unhedged exposure to e.g. very long-term renewable energy projects where secured revenue stream obligations are often necessary up-front to secure project funding, is just not feasible.

The potential for inappropriate application of the "same risk, same regulatory treatment" principle is concerning, also with respect to commodities market participants. There is a difference between commodity market participants and the broader NBFI population, which the FSB seems to have acknowledged in other reports. These firms have special and unique characteristics linked to physical assets and supply. They play a part in larger energy markets and their stability over periods of volatility – this effort seems to contradict this acknowledgement.

Recommendation 9

[The consultation report does not pose a question]

ISDA would also reiterate its view that most data about derivatives activities and exposures are available to regulators via trade repositories. Data at trade repositories allow for the extraction of relevant metrics such as notional outstanding, market to market valuations, data on sensitivities and other data points relevant from a financial stability perspective. However, those data are often not fully utilised by regulators and not shared between regulators with different responsibilities (prudential, market regulators, insurance regulators and central banks) and not shared across borders. If shared and utilised, such data could significantly enhance regulators' ability to monitor the build-up of risk exposures by leveraging shared data on risk exposures from counterparties. As of

now, cooperation among authorities, for example in the context of the UK gilt crisis, has been on an ad-hoc basis. Authorities should focus their efforts on streamlining transaction reporting and conducting Memoranda of Understanding on data sharing arrangements and address related legal and operational hurdles.[32]

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 76 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on LinkedIn and YouTube.

[32] The ISDA whitepaper 'hidden in plain sight?' discusses data on derivatives exposures and suggests solutions to overcome data sharing challenges. Available here.