FINANCIAL STABILITY BOARD

# Leverage in Non-Bank Financial Intermediation: Consultation report

## Response to Consultation

## Insight Investment

*Recommendation 1*

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

   The NBFI sector is diverse and a one-size-fits-all approach is inappropriate. It would be unlikely to meet the objectives of the FSB, and would potentially lead to unintended consequences and an increase in systemic risk, rather than a reduction. For example, hedge funds, pension funds, sovereign wealth funds and insurers are all very different in terms of their operations, structures and incentives.

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?**

   The FSB notes two channels of risk, one of which has already been addressed. Of the two channels - counterparty credit risk and position liquidation - we believe that counterparty credit risk has already been addressed effectively since the 2008 global financial crisis through international measures such as mandated central clearing and non-cleared margin rules.

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**

   Bank capital rules can help to ease the position liquidation risk channel. The second channel of risk, the position liquidation channel, can arise as a result of margining requirements of counterparty credit risk channel. Broadening the scope of eligible collateral that is accepted by banking regulation would help to ease some of this pressure. We also note that banks can often reduce their balance sheets in stressed times when NBFI entities' reliance on banks for repo financing typically increases. We would encourage policymakers to examine this and address any gaps that may be relevant for supporting financial stability.

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

   Bank capital rules can help to ease the position liquidation risk channel. The second channel of risk, the position liquidation channel, can arise as a result of margining requirements of counterparty credit risk channel. Broadening the scope of eligible collateral that is accepted by banking regulation would help to ease some of this pressure. We also note that banks can often reduce their balance sheets in stressed times when NBFI entities' reliance on banks for repo financing typically increases. We would encourage policymakers to examine this and address any gaps that may be relevant for supporting financial stability.

**(iii) concentration and crowded trading strategies**

Bank capital rules can help to ease the position liquidation risk channel. The second channel of risk, the position liquidation channel, can arise as a result of margining requirements of counterparty credit risk channel. Broadening the scope of eligible collateral that is accepted by banking regulation would help to ease some of this pressure. We also note that banks can often reduce their balance sheets in stressed times when NBFI entities' reliance on banks for repo financing typically increases. We would encourage policymakers to examine this and address any gaps that may be relevant for supporting financial stability.

## *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?**

The repo markets play a crucial role in financial stability and their importance must not be understated. By providing liquidity in times of stress, repo markets function to keep both position liquidation and counterparty credit risks low. Any inefficiencies introduced to the repo markets (such as by minimum haircuts or mandated repo clearing) would hinder their ability to provide this important function. The consequences could include missed margin calls in the cleared or non-cleared markets, increasing the probability of defaults, increasing counterparty credit risk, and exacerbating financial stability risk in crises such as the 'dash for cash' crisis in the early days of the pandemic.

## *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?**

Most of the NBFI sector is already well regulated. Entities such as pension funds, insurers and investment funds are typically highly regulated, with rules and frameworks tailored for the specific nature of these entities and the risks that they take. There may be a case for greater regulatory oversight for unregulated entities using leverage, particularly for speculative rather than risk management purposes.

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?**

Regulatory collaboration and information sharing could support effective regulation. This may be needed where certain authorities (for example, central banks) feel that they do not have sufficient oversight or visibility of the NBFI sector.

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?**

We would support authorities implementing a system-wide risk analysis to identify markets and sectors with meaningful risk exposures and for which regulatory focus could be beneficial. For such segments of the market, rules could be crafted to meet the specificity of that situation. A good example is of liability-driven investment (LDI) regulation in the UK, where rules were upgraded but still considered nuances, structural constraints and vulnerability of the index-linked gilts market as well as the objective of the pension fund sector. As a result UK defined benefit pension funds which use LDI exhibit significantly reduced risks.

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

In the UK we believe these proposals would go against the government's growth goals as well as previous policy decisions. Firstly, the minimum haircuts and mandated repo clearing would require more collateral to support repo transactions. This would likely have a negative impact on NBFI entities' investment into growth and other productive assets, going against the UK's investment and growth policy goals. Secondly, mandated clearing of repo transactions for UK pension funds creates the same risks and issues associated with the mandated clearing of derivatives, and would go against the UK government's recent decision to provide a long-term exemption for UK pension funds from mandated clearing of derivatives.

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

Minimum haircuts for repos can be a blunt tool and lead to increased counterparty credit risk. The impact of haircuts on NBFI should be taken into account. An NBFI entity of higher credit quality than the bank would be increasing its credit risk to the bank by posting haircuts. This would increase the credit risk in the system, going against the FSB's objectives.

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?**

Banks should set an appropriate haircut reflecting the risks posed when transacting with an NBFI entity. We understand that this is already a requirement under bank capital rules.

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?**

Any minimum haircut can hinder the repo markets' ability to support the financial system in a liquidity crisis. Repo markets play an important role in providing liquidity for entities to meet their margin calls from cleared as well as non-cleared margin requirements. Reducing the efficiency of the repo markets could hinder its ability support the financial markets.

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

    We question the proposal to enhance margining requirements between NBFI entities and counterparties. Robust global standards already exist on margin requirements for both cleared and non-cleared trades.

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?**

    It is important to ensure that any rules on margin requirements do not increase pro-cyclicality risks. We have observed cleared transactions where central counterparty (CCP) initial margins have spiked significantly in stressed periods, which leads to procyclicality risk concerns.

### *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?**

    Transparency from CCPs on their margining models could be improved. This may help to manage the risk of initial margin spikes in stressed periods, which the market has experienced.

### *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?**

    We support voluntary rather than mandated clearing of repos. Supporting voluntary clearing, we believe, would achieve the appropriate balance of encouraging clearing without forcing NBFI entities to take on risks that are not appropriate for them.

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?**

    Mandating NBFI entities to clear repos will bring minimal benefit and can introduce a number of risks. Central clearing requires variation margin to be posted in cash, which can increase stress in a crisis. Initial margin required by CCPs can also add pressure in a crisis, particularly if the margins required spike in stressed situations. Together, these requirements would increase liquidity risks (or position liquidation risk).

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?**

    Mandated clearing and the increased collateral requirements resulting from it would hinder the efficiency of the repo market, reducing its ability to provide liquidity in times of stress. This in turn could lead to missed margin calls in other markets, and in turn, increased credit risk

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

    Mandating repo clearing or NBFI entities would concentrate counterparty credit risk via a small number of clearing member banks, as opposed to a larger set of counterparty banks that operate in the bilateral market.

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

    We believe the authorities should support the development of better voluntary repo clearing models for clients including the sponsored clearing repo model. Currently only a few banks and service providers are set up to support this model.

### *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?**

    Dynamically increasing haircuts in stressed conditions would increase pro-cyclicality risk and exacerbate any crisis. This would go against the goals of the FSB. In banking regulation, where dynamic adjustments exist, they can work in a countercyclical manner (e.g. the countercyclical capital buffer). This helps to soften the impact of a crisis by reducing requirements in stressed times.

## Introduction

Insight Investment is a global asset manager with €757bn of assets under management[1], with offices in the UK, EU, US, Australia and Japan. Our clients include pension funds, sovereign wealth funds, insurers, financial institutions and individuals. We are grateful to the Financial Stability Board (FSB) for the opportunity to respond to this consultation.

We understand that the FSB's desire to identify and mitigate risks associated with non-bank financial intermediation (NBFI). We are concerned that the proposals have the potential for unintended consequences, leading to increased systemic risk. The proposals also run counter to the desire for growth in most jurisdictions.

## Background

1. **The NBFI sector is diverse and a one-size-fits-all approach is inappropriate.** It would be unlikely to meet the objectives of the FSB, and would potentially lead to unintended consequences and an increase in systemic risk, rather than a reduction. For example, hedge funds, pension funds, sovereign wealth funds and insurers are all very different in terms of their operations, structures and incentives.
2. **The FSB notes two channels of risk, one of which has already been addressed.** Of the two channels – counterparty credit risk and position liquidation – we believe that counterparty credit risk has already been addressed effectively since the 2008 global financial crisis through international measures such as mandated central clearing and non-cleared margin rules.
3. **Bank capital rules can help to ease the position liquidation risk channel.** The second channel of risk, the position liquidation channel, can arise as a result of margining requirements of counterparty credit risk channel. Broadening the scope of eligible collateral that is accepted by banking regulation would help to ease some of this pressure. We also note that banks can often reduce their balance sheets in stressed times when NBFI entities' reliance on banks for repo financing typically increases. We would encourage policymakers to examine this and address any gaps that may be relevant for supporting financial stability.
4. **The repo markets play a crucial role in financial stability and their importance must not be understated.** By providing liquidity in times of stress, repo markets function to keep both position liquidation and counterparty credit risks low. Any inefficiencies introduced to the repo markets (such as by minimum haircuts or mandated repo clearing) would hinder their ability to provide this important function. The consequences could include missed margin calls in the cleared or non-cleared markets, increasing the probability of defaults, increasing counterparty credit risk, and exacerbating financial stability risk in crises such as the 'dash for cash' crisis in the early days of the pandemic.
5. **Most of the NBFI sector is already well regulated.** Entities such as pension funds, insurers and investment funds are typically highly regulated, with rules and frameworks tailored for the specific nature of these entities and the risks that they take. There maybe a case for greater regulatory oversight for unregulated entities using leverage, particularly for speculative rather than risk management purposes.
6. **Regulatory collaboration and information sharing could support effective regulation.** This may be needed where certain authorities (for example, central banks) feel that they do not have sufficient oversight or visibility of the NBFI sector.
7. **We would support authorities implementing a system-wide risk analysis to identify markets and sectors with meaningful risk exposures and for which regulatory focus could be beneficial.** For such segments of the market, rules could be crafted to meet the specificity of that situation. A good example is of liability-driven investment (LDI) regulation in the UK, where rules were upgraded but still considered nuances, structural constraints and vulnerability of the index-linked gilts market as well as the objective of the pension fund sector. As a result UK defined benefit pension funds which use LDI exhibit significantly reduced risks.
8. **In the UK we believe these proposals would go against the government's growth goals as well as previous policy decisions.** Firstly, the minimum haircuts and mandated repo clearing would require more collateral to support repo transactions. This would likely have a negative impact on NBFI entities' investment into growth and other productive assets, going against the UK's investment and growth policy goals. Secondly, mandated clearing of repo transactions for UK pension funds creates the same risks and issues associated with the mandated clearing of

[1] As at 31 December 2024. Assets under management (AUM) are represented by the value of cash securities and other economic exposure managed for clients. Where the methodology defines it, some asset reporting focuses on cash securities only. Figures shown in EUR. FX rates as per WM Reuters 4pm spot rates. Reflects the AUM of Insight, the corporate brand for certain companies operated by Insight Investment Management Limited (IIML). Insight includes, among others, Insight Investment Management (Global) Limited (IIMG), Insight Investment International Limited (IIIL), Insight Investment Management (Europe) Limited (IIMEL) and Insight North America LLC (INA), each of which provides asset management services.

derivatives, and would go against the UK government's recent decision to provide a long-term exemption for UK pension funds from mandated clearing of derivatives.

## Activity-based measures: minimum haircuts for repos

9. **Minimum haircuts for repos can be a blunt tool and lead to increased counterparty credit risk.** The impact of haircuts on NBFI should be taken into account. An NBFI entity of higher credit quality than the bank would be increasing its credit risk to the bank by posting haircuts. This would increase the credit risk in the system, going against the FSB's objectives.
10. **Banks should set an appropriate haircut reflecting the risks posed when transacting with an NBFI entity.** We understand that this is already a requirement under bank capital rules.
11. **Any minimum haircut can hinder the repo markets' ability to support the financial system in a liquidity crisis.** Repo markets play an important role in providing liquidity for entities to meet their margin calls from cleared as well as non-cleared margin requirements. Reducing the efficiency of the repo markets could hinder its ability support the financial markets.

## Activity-based measures: enhanced margin requirements

12. **We question the proposal to enhance margining requirements between NBFI entities and counterparties.** Robust global standards already exist on margin requirements for both cleared and non-cleared trades.
13. **It is important to ensure that any rules on margin requirements do not increase pro-cyclicality risks.** We have observed cleared transactions where central counterparty (CCP) initial margins have spiked significantly in stressed periods, which leads to procyclicality risk concerns.
14. **Transparency from CCPs on their margining models could be improved.** This may help to manage the risk of initial margin spikes in stressed periods, which the market has experienced.

## Activity-based measures: mandated repo clearing

15. **We support voluntary rather than mandated clearing of repos.** Supporting voluntary clearing, we believe, would achieve the appropriate balance of encouraging clearing without forcing NBFI entities to take on risks that are not appropriate for them.
16. **Mandating NBFI entities to clear repos will bring minimal benefit and can introduce a number of risks.** Central clearing requires variation margin to be posted in cash, which can increase stress in a crisis. Initial margin required by CCPs can also add pressure in a crisis, particularly if the margins required spike in stressed situations. Together, these requirements would increase liquidity risks (or position liquidation risk).
17. **Mandated clearing and the increased collateral requirements resulting from it would hinder the efficiency of the repo market, reducing its ability to provide liquidity in times of stress.** This in turn could lead to missed margin calls in other markets, and in turn, increased credit risk.
18. **Mandating repo clearing or NBFI entities would concentrate counterparty credit risk via a small number of clearing member banks**, as opposed to a larger set of counterparty banks that operate in the bilateral market.
19. **We believe the authorities should support the development of better voluntary repo clearing models for clients including the sponsored clearing repo model.** Currently only a few banks and service providers are set up to support this model.

## Activity-based measures: dynamic haircuts

20. **Dynamically increasing haircuts in stressed conditions would increase pro-cyclicality risk and exacerbate any crisis.** This would go against the goals of the FSB.
21. **In banking regulation, where dynamic adjustments exist, they can work in a countercyclical manner (e.g. the countercyclical capital buffer).** This helps to soften the impact of a crisis by reducing requirements in stressed times.

## Entity-based and concentration measures

22. **Any entity-level requirement, such as leverage limits, is a blunt tool and can create cliff-edge risks as entities see this as a new limit to manage to.** This can cause forced-selling behaviours as entities approach this limit, which could exacerbate systemic risks. The same principle applies for any concentration and large exposure limits.
23. **Concentrated add-ons for haircuts and margins could increase procyclicality risks.** This is because an entity's positions could become more concentrated during stressed conditions if they use the repo markets to manage

liquidity demands. Hindering the repo markets at such times may lead to missed margin calls and therefore an increase in credit risk and defaults.

## Other measures

24. **Public disclosures could go against the FSB's objectives of reducing systemic risk.** In concentrated markets, an exit from the markets by a large investor could trigger herd behaviour if made public, thereby triggering a fire-sale in concentrated markets. This would increase rather than reduce systemic risk. MIFID rules already have robust pre- and post-trade transparency requirements. An alternative approach could be to ensure that other jurisdictions have similar transparency requirements.
25. **We caution against prescriptive regulatory requirement of private disclosures.** In principle we are supportive of ensuring that counterparties have sufficient disclosure from NBFI entities to assess the risk they are taking. However, we caution against setting regulatory minimum for this. Firstly, NBFI sector is diverse, and it can be difficult to apply the same rules. Secondly some of the proposals put forward in the consultation would le ad to the counterparties having access to information that we would deem to be too sensitive (e.g. detailed information of exposures across all vehicles/entities etc). We note that counterparties already have the option to not trade with any NBFI entity if they felt that the information they receive is inadequate for risk management. That being said, there may be some benefit in setting out some common definitions to ensure there are no differences in interpretation of certain metrics although the list in the annex seems overly extensive.
26. **We are concerned with the "same risk, same regulatory treatment" approach as there are structural differences between jurisdictions.** Regulatory architecture should incorporate sufficient flexibility to allow for this. Authorities are already strongly incentivised to align internationally even without such a rule.

**Insight would be supportive of greater regulatory collaboration and information sharing** between different types of regulators and authorises to ensure that any potential risk is scrutinised carefully. We would also support authorities implementing a **system-wide risk analysis** to identify markets and sectors where risk is identified and where regulatory focus can be beneficial, and where rules are crafted to meet the specificity of that situation. Finally, there may be a case for greater regulatory oversight for unregulated entities using leverage, particularly for speculative rather than risk management purposes.

Once again, we are grateful for the opportunity to respond to this consultation and we are available for any discussion on this topic.