Leverage in Non-Bank Financial Intermediation: Consultation report

Response to Consultation

Liberty Group Ltd

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 description is comprehensive and accurate.

   Additional Risks Include:

   -Exposure to Banks (Usually to the Big 4 in SA), which can lead to a domino effect in case of financial distress. This exposure is usually directional.

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?**

   Counterparty concentration risk as well as metrics aimed at measuring concentration in specific markets e.g. interest rate markets.

   Aggregated sensitivity metrics may be useful as well.

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

   Metrics aimed at assessing concentration in specific markets e.g. counterparty size of market and liquidity in that market.

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

   Industry specific regulatory disclosures, although it may also be useful to have some standardised metrics which will allow regulators to formulate an aggregated view of potential risks within NBFIs.

   (iii) concentration and crowded trading strategies

   No comment

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 proposed metrics all make sense but may need to be anonymised prior to disclosing e.g. counterparty concentration as a proportion of overall counterparty exposures.

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?**

   The both activity based and entity based measures seem sufficient. Rather than adjusting measures to suit specific types of NBFI's it may be more suitable to develop metrics that are aimed at capturing material risks across NBFI's which remain constant. This will allow NBFIs to embed metrics which in turn would allow for more regular and meaningful disclosures. Regulators should consider entity type (e.g. hedge funds) specific metrics in order to gain insights into specific nuances.

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?**

   These measures may be effective in reducing overall leverage to some extent in as far as it effectively increases the cost of leverage. The unintended consequence may however be that entities engage in more risky activities in order to produce the same level of shareholder returns.

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?**

   No comment.

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

   The proposed measures are seemingly aimed at reducing leverage by increasing implicit or explicit costs. Setting measures too conservatively may adversely impact on market efficiency by for example reducing arbitraging opportunities.

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

   Margining will ensure that collateral be placed as the market value of the underlying security fluctuates, which depending on how a stress event unfolds may assist in managing liquidity under stress or allow participants to unwind positions orderly. Whereas a haircut in isolation will limit the amount of leveraging upfront.

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?**

    The consultation report already seems to identify such circumstances. By limiting the amount of leverage through such measures the inherent risks that the report highlights is expected to reduce.

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?**

    If implemented entity based measures should be standardised for all NFBI, with specific overlays to differentiate between entity types e.g. hedge funds vs insurers. The standardised measures may be adjusted by regulators should they perceive an increase in risk within the broader financial system.

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

    The report calls out the potential risks to the real economy during times of stress, but regulators should also consider the implications of measures on the cost of doing business and the potential implications of limiting leverage on market efficiencies and dynamics e.g. price discovery and arbitrage.

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?**

    No comment.

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?**

    No comment.

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?

Such disclosures will be beneficial. There may however be concerns around protecting proprietary information as well as counterparty information. As such it may be useful to consider anonymizing such disclosures to leverage providers. Concentration to specific risk factors e.g. interest rates or equity prices as well as single counterparty exposures could be useful.

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?**

    Implementing such measures could increase the operational burden and consequently costs to the leverage users. Leverage users may be reluctant to disclose information if it is perceived to jeopardise their proprietary information.

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?**

    No comment.

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

    No comment.

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?**

    No comment.

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?**

    No comment.