FSB FINANCIAL STABILITY BOARD

Leverage in Non-Bank Financial Intermediation: Consultation report

Response to Consultation

Paris Europlace

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?**

Paris Europlace fully shares the FSB's ambition to have financial regulation adapted, in all jurisdictions, to the prevention and management of systemic risks, the preservation of financial stability and the protection of investors.

In this regard, the concept of NBFI remains too much imprecise and groups together entities whose activities and risks are very different, some of them being already subject to holistic regulatory and supervisory frameworks at international (FSB for money market funds, IAIS for insurance companies), European (EIOPA for insurance companies, ESMA for UCITS and AIFs funds) and national levels. It is therefore imperative to clearly define which sectors of the NBFI universe may require additional scrutiny and why. In the meantime, it would be counterproductive to indistinctly further strengthen the regulation applying to financial players who are often already largely regulated, in the hope of indirectly regulating non-regulated NBFIs, through their “interconnectedness”.

In particular, we believe that the European Union has already implemented a highly robust regulation of the financial sector including in most parts of the non-banking sector: any regulatory addition, if it is not properly assessed ex ante and if it does not target very specific and currently unregulated entities, could seriously hamper the competitiveness of financial institutions (in particular already regulated ones) and therefore affect the proper financing of the economy. Actually, private equity managers do not, through their funds, lend to the companies in which they have invested equity, nor do they increase the fund’s exposure by borrowing capital to make the investment. As a result, private equity funds are generally unleveraged, something that is reflected in data collected by national competent authorities.

So, we broadly agree with the FSB’s description of financial stability risks and we do not believe the FSB has omitted any specific vulnerabilities.

We note the inclusion in the FSB 2025-2026 work programme of further analysis of the NBFI sector along the following lines :

“Enhancing the resilience of the NBFI sector, while preserving its benefits. This has been a longstanding priority on the FSB’s agenda, particularly as NBFI continues to grow and

evolve. The FSB will continue to advance its work programme for enhancing NBFI resilience, which is carried out together with other standard-setting bodies (SSBs)."

As the FSB conducts this further analysis, we urge the FSB, when reporting to the G20 its final recommendations on NBFI leverage, to take stock of the status of implementation of earlier FSB policy recommendations in the main jurisdictions, and across the various categories of NBFIs, and to avoid making undifferentiated recommendations that would further penalize the jurisdictions already advanced in implementing leverage and liquidity tools, without evidence of additional financial stability benefits.

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?**

Leverage metrics remain important to assess the risks posed by funds. Entity-based measures, such as leverage limits at firm level, are relevant tools to determine whether significantly leveraged funds are posing a concern. The FSB's focus should be on genuinely excessive indebtedness, not on debt in general. For example, in the European Union, the AIFM Directive provides for specific provisions when indebtedness exceeds 300% of funds' NAV.

Also, developing further stress tests should not lead to additional requirements for firms that have already had to devote significant resources to reporting, including reporting to the banks and to credit funds in the context of existing legislation.

Most importantly, it would be important for any contemplated system-wide stress tests to provide meaningful comparison. For example, the level of leverage of a closed-ended fund at the beginning of the life of the fund may artificially appear much higher than the one of an open-ended fund, without this difference representing a similar level of risk for credit fund. Would stress tests not take this into consideration, we fear this could skew significantly the results of the exercise, to the detriment of its relevance.

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

(i) specific market activities, such as trading and investing in repos and derivatives

We find that leverage metrics remain the most valuable tools to determine the level of leverage of investment funds (UCITS and AIF funds). But in addition to the fact that measures should only target high indebtedness, international harmonisation of definitions, calculation methods and supervisory practices should be ensured.

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

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(iii) concentration and crowded trading strategies

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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 should be noted that, by contrast to companies which seek to raise capital from the public and are required to disclose and report to the public, private companies that raise capital by marketing to specific investors are not required to provide the same disclosure to the wider public, although they will of course provide information to these investors and finance providers. The same logic of course applies to private funds as opposed to public funds.

   The FSB should continue to acknowledge that forcing private fund managers to disclose public information could have significant consequences on the functioning of their industry, and affect the much needed confidentiality of deals. This is not to say that private fund managers, whether they raise capital from the public or not, should not be required in many (or most) jurisdictions to make non-public disclosures to regulators, if regulators need such information to take decisions, and obviously to their investors, something that is already well in place either through existing market mechanisms or through regulatory requirements in European jurisdictions.

   Similarly, regulators should be careful in asking information in a frequency that is meaningless for certain types of funds. In a private equity context, it is not rare that NAV figures are only updated infrequently given the illiquidity of asset classes and the lack of frequent transactions.

   Paris Europlace supports initiatives taken by domestic or international authorities aimed at increasing the exchange of recent and relevant data with the financial sector. This strengthens risk management by financial institutions and consolidates relations between authorities and financial institutions. This dissemination of data by the authorities must therefore be encouraged to reassure institutions that the reporting required of them can also be useful to them if financial institutions thus benefit from aggregated data in their sector.

   Finally, entities subject to the publication of information should be able to be exempted from the obligation to make strategic information public. Where information is likely to harm financial institutions, only the authorities should be able to request it.

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?**

   Granted, predicting a systemic crisis is particularly difficult because of the amplifying role that the mimicry of market behaviors can generate, the procyclicality of certain regulatory requirements or the lack of cooperation of certain jurisdictions. Therefore, Paris Europlace believes that regulation, in order to be properly implemented and efficient, requires that sufficient predictability be given to the financial sector regarding the timetable for the

application of these rules. Similarly, their relative stability over time is a factor in the proper understanding and application of regulation.

For these reasons, before considering additional regulation for the very diverse and poorly defined types of categories of NBFI, a clear distinction should be made, jurisdiction by jurisdiction, between institutions that are already regulated and supervised and those that are not. This preliminary work of granular mapping is essential to identify the risks that remain uncovered by regulation, assess their materiality and to then define how to better regulate and supervise unregulated entities in some jurisdictions.

In addition, when speaking about "Leverage in NBFI", the FSB should prioritize its action on High Leverage, which per se implies more financial stability risks than lower leverage. And maybe, ultimately, it should be the combination of high leverage as used by unregulated entities which should be considered as the top priority for action by the FSB. Overall, a comparative analysis of the regulations in place in the G20 jurisdictions should be conducted by the FSB in order to enable it to have a granular view of the present situation before expressing new recommendations to the G20.

Paris Europlace disagrees that additional regulations are necessary in a uniform manner for all jurisdictions. Management by exception would be more effective in order to identify, depending on the activities and jurisdictions concerned, which new risks emerge from certain players or in certain countries. Indeed, precise and targeted regulatory provisions are crucial to be relevant and to usefully limit the transmission of shocks. Regarding minimum haircuts, applying this would make the repo market more expensive, reduce its capacity to provide liquidity in times of stress and make government bond markets more vulnerable.

In addition, and as already mentioned above, before considering regulation for the very diverse and poorly defined categories of NBFI, a clear distinction should be made, jurisdiction by jurisdiction, between institutions that are already regulated and those that are not. This preliminary work of granular mapping is essential to identify the risks that remain uncovered by regulation and to then define how to better regulate and supervise unregulated entities in some jurisdictions.

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?**

We believe that the best regulation is the one that combines an entity approach and a risk approach. However, the entity approach should be a priority, because NBFIs are too broadly defined. Furthermore, the activity approach should be limited to cases of high leverage.

Regarding the tools, we suggest that initial margins and margin variations can be settled not only by cash, but also by high-quality securities: this would allow, in the event of market stress, to see systemic risk increase as securities must be sold to obtain cash to be posted as collateral.

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?**

   Regulatory provisions, especially those surrounding the prevention or management of systemic risk, must be transparent, stable and predictable so as not to create additional uncertainty or give rise to counterproductive, or even dangerous, strategies on the part of certain market participants. International consistency must therefore be a priority for FSB.

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

   It is more complex to have an activity-based approach rather than an entity-based approach when the institutions in question are NBFIs. We favor the choice of an entity-based approach that focuses on high levels of indebtedness.

   Here again, the measures taken must be transparent and predictable so as not to have pro-cyclical effects. Prior consultation with all market players would be desirable in order to better understand the impacts in a crisis situation.

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

   These two measures seem to us to be suitable for use in stressed situations.

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?**

    We agree with the FSB that leverage limits at entity level can be a good solution. However, imposing these limits without appropriate grandfathering could also cause a concern for closed-ended funds. Specific care should therefore be for the rules to start applying in a way that takes into account the situation of the fund. Otherwise, we see a risk of developing rules that, at least for a time, could be counterproductive.

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

    The calibration of entity-based measures needs to balance risk mitigation with avoiding restrictions on beneficial aspects of NBFI leverage. Authorities should certainly consider a suite of toolkit metrics to identify and monitor vulnerabilities related to NBFI leverage. In the EU, methods used are often too simplistic to assess whether a fund is actually causing a concern, creating a situation where many funds posing little risk are considered leveraged, which leads to situations where regulators do not concentrate on the riskier types of activities.

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

    Basing regulation on the nature of entities may be ineffective in managing systemic risk if risk analysis is not also conducted. Two joint approaches are required, one by the entities and the other by the activities. This would make it possible to identify which entities are

already regulated, what is the nature of the risks taken, whether existing regulation is appropriate or whether, on the contrary, additional provisions would be desirable.

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

As already mentioned above, the combination of high leverage with non-regulated NBFIs should be prioritised within the scope of application of FSB's Recommendations, as those entities are badly known by regulators and embed obvious systemic risk on the market.

Regarding minimum haircuts in SFTs, we do not agree, in particular as many government bonds are highly liquid. Such haircuts would increase the cost of funding by liquidity providers, leading to less activity on markets and therefore may generate undesirable spillover effects. For us, it seems better to regulate markets, including derivative markets (such as EMIR, SFTR, UCITS, AIFMD in the EU). Indeed, the remaining key risk remains in the area of non-regulated NBFIs (i.e. poorly transparent and therefore poorly monitored by regulators).

As for enhanced margining requirements, we do not see either the need for them in derivatives markets. On the contrary, for instance we should facilitate the collateralisation of variation margin calls on centrally-cleared markets through hiqh-quality securities, such as government bonds. In addition, from an EU perspective, there was no significant issue on EU derivative markets, as EU derivative markets are strictly regulated by EMIR, and the vast majority of participants are regulated too.

Concerning the way to reinforce the resilience of non-bank financial entities, one key solution from a financial stability perspective would be to allow for high-quality securities to be used on centrally-cleared derivative markets, as collateral to use for variation margin calls (in the same way as they are already recognised on non-centrally cleared markets, e.g. through EMIR in the EU). Thus, it would avoid the risk of "dash for cash" and related procyclical effects.

An additional key improvement would be to increase the transparency to clients of CCP risk models, as a way for clients to be able to anticipate the potential risks and the increases of margin calls. Worldwide, some CCPs already ensure such a risk model transparency to clients, but not all CCPs yet.

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?

Paris Europlace believes that the BCBS standards, recommendations and guidelines are very widely reflected in the regulatory provisions already in force in the European Union. However, these same international standards are ignored or postponed in their application in a very significant number of jurisdictions, some of which are home to a financial sector that is very important for financial stability and the management of systemic risks in developed countries.

For this reason, the growing divergence between national regulations increases the risk of regulatory arbitrage, creates additional distortions of competition and competitiveness between institutions in the same sector and undermines the credibility of the actions pursued by international regulatory authorities. A rapid and comprehensive harmonisation of current regulations is more urgent than ever to avoid this fragmentation. This should be a priority for the FSB.

We fully agree with this recommendation 6, but its proper implementation requires a thorough assessment of counterparty risk, towards regulated NBFIs and even more so towards unregulated NBFIs. In the euro area, regulation, as reinforced by the ECB, is particularly strict for AIFs and UCITS funds in terms of reporting on positions or inventories, which must be addressed to the financial markets supervisor and the central bank of the country concerned (in the European Union, it is also valid for AIFs funds). Generally speaking, it is the OTC activities of unregulated NBFIs that are the least transparent. Data collection and sharing across authorities and with the private sector shoiudl therefore be a priority.

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?**

    Paris Europlace believes that only unregulated institutions should be subject to additional regulation. In the European Union, the financial sector is much more regulated than in other jurisdictions: it should therefore be simplified and not strengthened, because the regulatory cost is very significant and increasing. It is also important for supervisory authorities to make the best use of the very precise, sometimes daily, data that they already have, in order to properly enforce regulation. A better exchange of data between authorities (between securities regulators, between central banks and across sectors to avoid “silos” or black boxes) should also make a useful contribution to this.

    Limiting systemic risk requires the FSB to pay particular attention to unregulated NBFIs with high debt ratios. Furthermore, a comparative review of regulations among G20 jurisdictions concerning regulated NBFIs would make it possible to detect areas for improvement in a certain number of regulations. Indeed, Paris Europlace considers that the regulation in the European Union, and even more so in the eurozone (where the applicable regulatory frameworks have been further strengthened by the ECB), is very prescriptive and has proven its effectiveness in managing systemic risk, in recent episodes of volatility.

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?**

    The FSB should acknowledge that managers are already subject to intense scrutiny, including from the need to give their lenders information required under law to these lenders. It is unclear how additional data could represent a real improvement to the current data. On the contrary, we know from experience that regulators do not already make use of the entire

set of data that is at their disposal. We would therefore rather suggest streamlining and operationalizing the information that needs to be available, instead of creating new data points that may overlap with some of the ones already available.

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?**

    Providing a minimum set of regulatory provisions on disclosures is not sufficient to address systemic risk without an immediate focus on the key areas in this area, namely unregulated and highly leveraged NBFIs. Moreover, more than regulatory principles, the examination of national supervisory practices is crucial to limit financial risk at the global level.

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?**

    Reporting requirements are too disparate across jurisdictions. A comparative analysis by the FSB would be invaluable to illustrate this and to recommend regulatory upgrades in jurisdictions where this appears necessary.

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?**

    Paris Europlace considers that the proper management of systemic risk requires precise and harmonised regulation between jurisdictions. In this sense, prescriptive texts are useful and more effective than soft law, as demonstrated by the recent history of systemic crises in certain countries. However, once these clear rules have been established and properly supervised, it is important that the authorities contact the institutions to best adapt these rules to market situations and the nature of the entities concerned: in this specific case, consultations, hearings and regular exchanges with the financial industry are essential in order to establish a dialogue between the authorities and the financial institutions.

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?**

    Paris Europlace believes that the principle of “same risk, same regulatory treatment”, is highly unclear in practice. For instance, applying the exact same requirement to every asset manager irrespective of the specific features of fund (for example applying the same leverage rules to closed-ended and open-ended funds) can lead to different outcomes. Moreover, it is also unclear how the FSB could determine what is effectively the “same risk” for two entities with very different business models. It would perhaps be more meaningful to think about “same effect” on financial stability, as opposed to overall perceived level of risk.

In addition, a growing regulatory fragmentation is evident in prudential banking regulation, for example, but also in insurance and asset management. There is significant work to be done by authorities to ensure that rules that are comprehensive remain meaningful. The competitiveness of players established in the European Union is therefore significantly penalised by these regulatory distortions, which persist, or even worsen, and could continue to diverge in the short term. The FSB and BCBS should urgently focus on these issues. Otherwise, the analysis, prevention and resolution of systemic risks would continue to remain fragile and incomplete.

The current regulatory framework for NBFIs has not been designed with the macroprudential aim of reducing the build-up of systemic risk. Rather, it has a strong focus on ensuring investor protection and market integrity. These are, of course, critical public policy objectives – and entirely complementary to financial stability. Indeed, financial stability and the reduction of systemic risk is a precondition for investor protection. However, the systemic perspective is different: it goes beyond the conduct and solvency of individual entities to focus on the potential impact that NBFI vulnerabilities could have on the broader financial system and economy, including – but not solely related to – investors in NBFI entities.

Faced with this regulatory fragmentation, a source of vulnerabilities for investor protection, the FSB should immediately conduct a review of the regulations applicable within the G20 in order to detect where the flaws and the loopholes are likely to create a systemic risk.

Paris Europlace believes that the principle of "same risk, same regulatory treatment" is unreliable and not very operational in practice. Indeed, even if two entities (for example, a bank and an unregulated NBFI) pursue the same activity, it would be wrong to believe that they represent the same risk for the financial system as a whole, nor that their financial structure would allow to apply the same prudential framework. It would therefore be useless, if not dangerous, to increase the regulatory burden on the already regulated financial sector. On the contrary, the FSB's priority should be on unregulated NBFIs posting high debt ratios.