

Leverage in Non-Bank Financial Intermediation: Consultation report

Response to Consultation

SOMO

Recommendation 1

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

Firstly, the recommendations should be complemented with the recommendation that when the authorities do not have the possibility e.g. due to financial or human resources and skill constraints, to implement the recommendations, they should limit or ban the entities and activities that use high leveraged strategies. This would avoid regulatory arbitrage and hidden cross-border leveraged strategies.

Should the proposed recommendations be calibrated according to the nature of the shocks e.g. sudden climate risk emergency, geopolitical risks, etc., each of which will have different effects on different entities and strategies for which leverage is used? Or, what if all leveraged activities will be affected at the same time: does that require a total cap on leverage per NBFIs subsector or per NBFIs entity or activity characteristics? The recommendations should promote more ex-ante entity-based and activity-based limits on leverage since perfect calibration will be difficult to achieve, especially for entities related to core economic and basic public services (bought by private equity) activities.

The recently growing NBFIs, such as private credit, and future new NBFIs e.g. based on AI designed strategies, might be using more complex hidden leverage and transferring of risks, and need to be subject to enhanced strict supervision, guidance, regulation and legislation. The use of any AI designed and AI run strategies should not be used until being approved after supervisory scrutiny and be subject to regulatory oversight.

Most recommendations are related to outside-in shocks, i.e. how to avoid risks and financial instability from leverage from outside shocks. However, to be comprehensive, there should also be recommendations on how to avoid that high leveraged entities create shocks, for instance by using AI in unforeseen ways, digital glitches from too little cyber-security protection in place, or too much speculative bets on energy and food commodities or housing prices which results in a regulatory backlash that affects the leverage.

Overall, there should be an assessment of which leveraged activities and entities are useful for the economy and societal challenges, and whether non-useful complex and hidden leveraged activities should be forbidden e.g. by forbidding counterparties to deal with them,

in order to reduce spending supervisory and regulatory capacity on non-useful leveraged activities.

2. What are the most effective risk metrics that should be considered by authorities to identify and monitor financial stability risks arising from NBF1 leverage?

Leverage metrics, concentration risk metrics, and combined positions of non-bank financial entities with similar business models or investment strategies.

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

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?

Publicly disclosed information such as transaction volumes, outstanding amounts, aggregated regulatory data, are useful as well as regular analysis by financial authorities. Regarding commitment of trading reports (CoTs) for commodity derivatives trading, the EU requirements to non-financial entities to report whether they are hedging or non-hedging, which is published in the weekly CoTs, should be integrated in reporting and public disclosure requirements in non-EU jurisdictions.

Regarding trade-offs for public disclosures, the need for availability of information that is useful and timely for policy makes and independent analysts (including academics) should also be taken into account.

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 leverage strategies by private equity should be of concern not only because of high and changing interest rates which might increase the leverage related risks, but also because private equity is buying up more and more services that are important in society such as health services, education, housing: research in many countries has revealed the disruption of these essential services by too highly leveraged private equity that went bankrupt or ceased the services to avoid bankruptcy.

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 NBF1 leverage in core financial markets, including government bond markets? To what extent can these three types of policy measures complement each other?
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?
9. For non-centrally cleared securities financing transactions, including government bond repos, what are the merits of margin requirements compared to minimum haircuts?
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 NBF1 leverage in core financial markets?

when the leverage can become too high so that core financial markets would be affected by instability and crisis when leveraged entities or activities are in stress: ex-ante measures are preferable/

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 NBF1 leverage?
12. Are there any potential unintended consequences from entity-based measures beyond those identified in the consultation report?
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?

Important considerations are how to strengthen and reinforce each of the measures by combining them so that no entity or activity is not covered.

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 NBF1 leverage in core financial markets, such as government bond repo markets? In what circumstances can they be most effective?

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 NBF1 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?**
- 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?**
- 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?**

yes, they should be required to do so and be informed that this requirement exists (preferably from what level of stress onwards).

- 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?**

Authorities design a minimum set of harmonised disclosures and guidelines on its application, through supervisory guidance that will be transposed in regulation and law after the guidance have proved to be effective.

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?**

All family offices and private credit engaging in leveraged activities from a particular threshold onwards, should be subject to same activities same rules.