FSB FINANCIAL STABILITY BOARD

Liquidity Preparedness for Margin and Collateral Calls: Consultation report

Response to Consultation

AFG

1. **Does the outlined approach identify all key causes of some non-bank market participant's inadequate liquidity preparedness with respect to spikes in margin and collateral calls during times of stress? Are there any sector specific causes that should be considered?**

   Introduction :

   The AFG wants to thank the Financial Stability Board for having the opportunity to answer this consultation on NBFIs' liquidity preparedness for margin and collateral calls. We agree with the importance and usefulness of the FSB's work on this field and globally agree with the high-level recommendations that are being proposed in the FSB paper.

   Before entering the details of the FSB's recommendations and as a preliminary remark, we would like to inform the FSB that the AFG recently responded to the three IOSCO consultative reports on initial margin (IM) and variation margin (VM) in cleared and uncleared markets for which IOSCO seeked input from market participants. Given the interconnected nature of the FSB's and IOSCO's work, we believe that our responses should be seen as complementary to one another. As such, we would like to recall a few key points we made to IOSCO, that we consider essential to ensure liquidity preparedness and that the FSB should have in mind while setting its own recommendations.

   It is paramount for clearing members (CMs) and their clients to be able to mitigate destabilizing changes in margin requirements notably in period of stress. As such it is essential to get sufficient transparency and predictability on Central Counterparty Clearing Houses (CCPs) and CMs' margin models with enhanced simulation tools (explaining various components of margin close of business and intra-day calls, add-ons and triggers). These tools must be easily interfaced by clients at a reasonable cost.

   Moreover, sufficient and harmonised notice periods should be provided before any adjustment is implemented in the calibration of CCPs and CMs' margin models, including for add-ons, changes to buffers and multipliers. It allows clients to better anticipate the provision of collateral by dealing with liquidity management, sourcing of liquidity.

Finally, as we have been insisting on for previous years now, we would like to re-emphasize the importance of being able to post non-cash VM as it is already the case for initial margins (IM). This is a critical issue, in particular in stressed market conditions as if VM has to be posted in cash only, it creates the need for either selling securities (including top quality ones) on the market and then amplifying the market stress, or posting them on the repo market while the market conditions make it very illiquid (and such posting amplifying again the market stress). From a financial stability perspective, allowing the posting of top-quality securities (such as government bonds) for covering VM calls would play a positive role in such conditions (and more widely). As such, any type of collateral (cash and non-cash) authorised under EMIR should be accepted.

Know these key points have been made, we would like to raise a few preliminary remarks on the FSB recommendations.

We globally agree with the recommendations set in that paper and with the general objective of increasing preparedness for margin and collateral calls and notably in case of a stressed market.

We also agree on the importance of adding proportionality and materiality in the setting of these recommendations by considering the different level of risks taken by each actor due their profile disparities. For instance, differentiation must be made between regulated players already subject to a certain level of rules on liquidity risk management (it’s the case for investment fund for instance which are subject to ESMA guidelines stress testings for UCITS and AIFs), and non-regulated ones which are not submitted to those rules, nor to regulators/supervisors’ approval and supervision, and who should be further concerned by these developments. The paper refers to the Archegos case which typically falls in that second category, and who might have deserved a more robust framework in terms of risk management, liquidity stress testing, stronger enforcement by authorities etc.

Proportionality and materiality should also be reflected by applying the recommendations at fund’s level and only to those that have a significant liquidity risk embedded in their profile, typically when use of derivatives. Most investment funds do not rely on derivatives in their investment policy, so do not have to post margin and collateral. Imposing these recommendations to all funds or at the asset manager’s level would be disproportionate.

As developed further in our response, we believe recommendation 7, which imposes to hold minimum cash buffers, to be very dangerous. Instead of imposing to maintain sufficient level of cash readily available, we would suggest broadening the scope of eligible collateral by allowing highly liquid securities and from high quality to enable to respond to margin and collateral calls within the necessary timeframe.

We support the FSB's recommendation that there should be regular interactions between market participants, counterparties and 3rd party service providers. However, examples given in Annex 3, which seems to require in all cases a quarterly review with each of prime brokers and largest counterparties may not be appropriate in all cases for fund managers.

Lastly, we believe banking supervisors should ensure a closer monitoring of the counterparty risk assessment made by banks. Indeed, as seen with the Archegos case, the the assessment made by Credit Suisse of the non-regulated counterparty risk had not

been properly carried out nor was it identified by supervisors. More generally we are in favour of consistency across the financial system when justifiable. In any case, FSB recommendations shouldn't create an unlevel playing field that might create opportunities for regulatory arbitrage.

Q1 :

We re-iterate the need to have clear distinctions within NBFI. Indeed, some NBFI are already regulated and submitted to several requirements regarding liquidity and risk management while others are not. Measures must be set considering the risk profile of different entities. The Archegos failure and LDI crisis cannot be systematically used to say that there is a big issue with NBFI. Both cases are not representative of regulated investment funds who, on the contrary, have rules to follow especially on liquidity management.

In addition, the role of regulators needs to be strengthened. Although the FSB proposes a proportional approach that we favour, it is not clearly identified that the lack of preparedness by some actors lies in inappropriate compliance of some rules such as KYC or counterparty risk obligation – as well as some failures by some banking supervisors on monitoring such compliance by banks, for instance in the Crédit Suisse/Archegos case. Regulators should also be particularly vigilant to concentration between a limited number of counterparties. They have the power to obtain information from these actors, to supervise them and enable enforcement which could resolve part of the issues raised in the FSB consultation.

As for any other recommendation, it should be clearly specified that requirements on liquidity risk appetite statements and funding contingency plans should apply only to investment funds using some derivatives in their investment policy.

Lastly, it seems essential the FSB's recommendation should not create regulatory arbitrage between different jurisdictions. As such, we believe that reference to "extreme but plausible stress scenario" should be further define or modified to avoid any interpretation. Consistency, transparency and predictability in collateral and margin calls are key to ensure stability in the market and notably in stressed conditions. Therefore cross-jurisdictional divergence should not be possible.

2. **Is the scope of the proposed policy recommendations appropriate?**

We believe that the proposed policy recommendations are not appropriate for each cases. From an asset management perspective, these recommendations should apply only to investment funds which use derivatives above a certain threshold and have a level of leverage. It is inappropriate to have such rules for all funds or application at the asset manager's level.

In addition, more scrutiny should be made by supervisors on the right level of assessment banks are doing regarding counterparty risk (excessive level of risk or leverage).

We also reiterate our message regarding CCPs' and CMs' role and on the need for better transparency and predictability and namely but not limited to, by providing margin models and enhanced simulation tools and sufficient notice period when modifying their models.

3. **Is the focus of the FSB's policy recommendations on liquidity risk management and governance, stress testing and scenario design and collateral management practices appropriate? Are there any other areas the FSB should consider?**

   We believe that no "one size fits all" approach should be applied but that the recommendations should be set considering the nature and differences of entities (ex: regulated NBFI and non-regulated ones for instance, funds that rely on derivatives in their investment policy and funds that don't etc.). Indeed, the FSB must keep in mind that some actors are already subject to some rules (see Q°4 below).

   Should also be considered our previous messages on the need for more transparency from CCPs and CMs and for a stronger monitoring and enforcement role of authorities over some entities notably.

4. **Is the approach to proportionality and materiality clear for all non-bank market participants?**

   We support the approach provided it clearly distinguishes between regulated and non-regulated NBFIs, acknowledging that regulated NBFIs are already subject to a certain number of rules with the same objective as the FSB recommendations.

   In addition, our key recommendation is to envisage such recommendation at fund's level instead of entity's level.

5. **Section 3.1 sets out key elements of a liquidity risk management framework to identify, monitor and manage liquidity risk exposures arising from margin and collateral calls. Are these sufficiently clear for all non-bank market participants?**

   3 recommendations are made regarding the setting of liquidity risk management framework:

   1) Take into account liquidity risk arising from margin and collateral calls in their liquidity risk management and governance framework: we believe this recommendation is acceptable providing the above-mentioned high-level remarks on proportionality and materiality that should be differentiated between regulated and non-regulated NBFIs, considering the measures some entities already have in place du to other pieces of regulation and considering the use or not of derivative.

   2) Have in place contingency funding plans: again, we believe that this measure shouldn't be applied as a "one-size fits all" approach. For instance, the examples provided for in Annex 3 should not be applicable to fund managers as risks are assessed at the fund level and not at business line level.

Furthermore, it seems impossible to guarantee that liquidity needs "can be met" at all times and even more so in period of market stress. Therefore, this demand should be nuanced and set as an obligation of means instead of an obligation of result. Indeed, we never know in stressed conditions how things will go no matter how many stress tests and contingency plans.

3) Regularly review risk frameworks: like others, this recommendation should be set by distinguishing between actors. For instance, it is much more appropriate for leveraged funds than for ones that are not. Overall, the FSB must be careful not to lay disproportionate and unjustified constraints on actors with low liquidity risk. The measures must be set depending of each portfolio and mustn't be applied in the same way for each fund.

We believe that asking market participants to calibrate their risk profile depending on the concentration other market participants could have seems to be inappropriate as they might not have access to such level of information. Authorities should play an important role in that matter as they have a broader picture.

6. **Are the recommendations on liquidity stress testing and scenario design with respect to margin and collateral calls clear and sufficiently specified?**

We generally agree with these recommendations on liquidity stress testing and scenario design. However, it should be clearer on the level of application, i.e. For fund managers, stress tests should be carried at an individual entity level as aggregating between all funds make no sense as they are autonomous from one another.

Furthermore, such recommendations should only be set where applicable (proportionality). For instance, for non-regulated players and avoiding capturing funds that are not leveraged.

We also believe that CCPs and CMs must play an important role in enabling entities building their liquidity stress tests and scenarios by providing them enough transparency and predictability (see our response to IOSCO).

Moreover, we are not comfortable with the fact that, by building these stress tests, entities must consider the actions of counterparties and other market participants experiencing liquidity stresses. Indeed, this would be very burdensome and practically impossible as AM, unlike regulators, do not have exhaustive knowledge of all market participants experiencing liquidity stresses.

In Annex 3, the FSB requires that the liquidity stress tests and protocols ensures that assets can be accessed and liquidated within a projected time horizons. This recommendation should be turned into an obligation of means and not of result as no one can ensure/predict that it will be possible to liquidate the asset before a market stress occurs.

The FSB recommends that robust stress testing should analyse a ranger of extreme but plausible liquidity stresses causes by changes in margin and collateral calls. This can only be possible if there is enough transparency from CCPs and CMs. It is not in the hand of

market participants. We therefore reiterate the point raised to IOSCO and which should better be considered by the FSB which is the need for increased transparency in CCPs and CMs' risk models and longer notice period for market participants/end-users to be able to anticipate. The recommendation also stipulates these stress testing should analyse changes in market participants' overall liquidity positions. As previously explained, we believe this recommendation to be too burdensome and extremely difficult to meet as end-users lack exhaustive knowledge of all market participants' positions. If the FSB wants to maintain this recommendation, we highly suggest that it should be clarified as being an obligation of means and not of result.

7. **Are there any jurisdictional or sector-specific differences that are not accounted for in the recommendations?**

As mentioned previously, it is important that a "one size-fits-all" approach is retained for all NBFI as this term refers to quite different products and activities. In addition, some are already highly regulated while others remain totally outside any specific regulatory framework. Focus should be on the latter ones and existing rules should be taken into consideration.

8. **Collateral readiness at the right time, quality and location is a critical aspect of effective liquidity preparedness for spikes in margin and collateral calls to mitigate the risk of having to liquidate collateral under stressed market conditions. Do the FSB's recommendations in Section 3.3 address all key elements required to be effective in mitigating liquidity risk arising from margin and collateral calls?**

FSB sets out a recommendation ensuring market participants maintain sufficient level of cash and readily available as well as diverse liquid assets. We believe it is very dangerous to set minimum cash buffers in terms of liquidity and believe that a better solution would be to broaden the range of eligible assets to meet with collateral requirements and support the possibility to post non-cash collateral including for VM. Indeed, as we have insisted on for previous years now, we would like to re-emphasize the importance of being able to post non-cash VM such as government bonds as it is already the case for initial margins (IM). This is a critical issue, in particular in stressed market conditions: if VM has to be posted in cash only, it creates the need for either selling securities (including top quality ones) on the market and then amplifying the market stress or posting them on the repo market while the market conditions make it very illiquid (and such posting amplifying again the market stress). From a Financial Stability perspective, allowing the posting of top-quality securities (highly liquid such as government bonds) for covering VM calls would avoid pro-cyclicality and play a positive role in such conditions (and more widely).

9. **Are there any material challenges to collateral management practices that some non-bank market participants may face that should be considered?**

As stated above, we believe the scope of eligible assets to meet with collateral requirements should be broadened to allow the posting of non-cash securities from high quality, such as government bonds, both at CCP level and at clearing member level. As already pushed through in our IOSCO response, a great focus should also be made on the ability for CCPs and CMs to provide for transparency and predictability to market participants.

If you have any additional comments, please provide them below.