Liquidity Preparedness for Margin and Collateral Calls: Consultation report

Response to Consultation

Bank of Russia

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?**

   We agree with the main causes of some non-bank market participant's inadequate liquidity preparedness for the liquidity shortage caused by the rapid growth of margin calls identified in the Consultation report.

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

   We note that the FSB Report does not pay due attention to the risk that a company's margin call will not be executed and/or will not be submitted in a timely manner. In addition, we note that we deem it necessary to include in the Report a discussion on the issue of considering blocked assets when assessing liquidity, as well as cross-border transactions between jurisdictions, the speed of which may be reduced or limited due to the increased compliance procedures.

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?**

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

   We believe that the practicalities of implementing the approach to "proportionality" of the applicable recommendations to market participants' baseline risks and "materiality" of risks associated with the rapid growth in margin requirements for non-bank market participants remain not completely clear.

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?**

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

   We note that the recommendations prescribe stress testing in a very vague manner without disclosing specific approaches to stress testing. We believe it would be worthwhile to set out in the FSB Report a standard methodology for conducting liquidity stress testing, which could be used at least by small companies that do not have sufficient competence to develop the methodology themselves. We consider it necessary to establish minimum time horizons (day, week, month), in the context of which liquidity under margin requirements and collateral should be assessed.

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

   We consider it reasonable to note that the possibility of a broker to use clients' funds for his own benefit, which is provided for in the Russian regulation, may also be the source of vulnerabilities and a stress amplifier. Thus, a source of liquidity risk is the provision of loans by the broker to some clients at the expense of other clients' funds, use of clients' funds for fulfillment by the broker of its own obligations and (or) obligations of its other clients. Accordingly, a situation may arise when a broker has sufficient collateral to cover obligations from securities transactions and derivatives, but, in fact, positions of some clients are covered by assets of other clients.

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?**

   Developing the topic of broker default risk control outlined in the Report, it is worth mentioning the practice used in the regulation of Russian brokers to comply with the Risk Coverage Ratio (RCR)1 and RCR2 - the standards limiting market risks arising from the execution by brokers of securities and derivatives transactions at the expense of clients' funds. If RCR1 (RCR1<0) is triggered, the broker is prohibited from increasing client positions, and if RCR2 (RCR2<0) is triggered, the broker must reduce (close) client positions. In order to assess the adequacy of collateral to cover open client positions, a broker must calculate the amount of collateral taking into account the risk rates, which must not be lower than the risk rates for stock instruments calculated by clearing institutions. At the same time, different risk limits are set for leveraged transactions executed by a broker at the expense of a client depending on the client's category.

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

   One of the key challenges faced by clearing members during the market turmoil is the lack of liquidity to meet margin calls that may drive some clearing members to reduce positions, negatively affecting trading liquidity. In some cases, action by smaller players with less liquidity resources have exacerbated price volatility in the relevant market, as they preferred to unwound positions instead of meeting higher margin requirements.

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