FSB FINANCIAL STABILITY BOARD

Liquidity Preparedness for Margin and Collateral Calls: Consultation report

Response to Consultation

ICI Global

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?**

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

   The Consultation proposes to apply the FSB's recommendations to non-bank market participants which the FSB defines as all market participants that are not commercial banks or central counterparties.

   We generally find the scope to be appropriate, but it is critical to bear in mind the diversity of non-bank market participants. As the Consultation acknowledges, "non-bank market participants represent a broad range of sectors, and their liquidity risk management needs and practices differ widely." Consultation at 11. Some non-bank market participants are already subject to robust liquidity management frameworks and these frameworks mitigate the potential for liquidity risks that can arise following spikes in margin and collateral calls.

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?**

   Although regulated funds were able to meet margin calls during the unprecedented market stress during March 2020, we believe that increased transparency could help regulated funds and other market participants to better prepare for future market stress events and mitigate the challenges associated with meeting unexpected margin calls.

   In March 2020, the overwhelming majority of regulated funds, including US-domiciled regulated funds, continued to function normally and redeem shares upon demand. Consistent with their normal operations, regulated funds also continued to meet their margin calls. As the Basel Committee for Banking Supervision (BCBS), the Bank of International Settlement's Committee on Payment and Market Infrastructures (CPMI), and the International Organization of Securities Commissions (IOSCO) concluded, more than 93 percent of clients, including all regulated funds, met margin calls on the day they were due, with no significant changes in these figures across February, March, and April 2020. See BCBS-CPMI-IOSCO, Review of margining practices (29 September 2022) at 32. Through robust liquidity risk management programmes, internal stress testing, and the flexibility to use a range of liquidity and liability management tools, regulated funds were able to appropriately prepare for and meet redemption requests and ensure that margin calls were fully and timely paid.

Nevertheless, global regulators can improve margin practices in the derivatives and securities markets, by making margin collection more transparent and efficient to alleviate downstream stresses on the broader financial system.

Transparency of margin processes is critical to liquidity preparedness. The problem is particularly acute in cleared markets, where initial margin (IM) is the cornerstone of central counterparty (CCP) risk management, but the CCP methodologies for calculating cleared IM requirements are relatively opaque. As a result, end-users have unsuccessfully sought the transparency to anticipate and plan for changes. We agree with the Consultation that CCPs and intermediaries can play an important role in helping their clients better prepare for spikes in margin and collateral calls by providing transparency on their margining practices. Consultation at 3.

To that end, ICI and its members have long supported efforts to enhance the transparency and governance of margin practices in cleared and non-centrally cleared markets. See, e.g., Letter from Jennifer S. Choi to BCBS, CPMI, and IOSCO Secretariats re Consultative Report on Review of Margining Practices (26 January 2022) (ICI Phase 1 Margin Letter). Notably, in their capacity as end-users, individual ICI members have contributed to several industry efforts to develop and offer sensible recommendations toward achieving these objectives, including as members of a key Commodity Futures Trading Commission (CFTC) Market Risk Advisory Committee (MRAC). See, e.g., CFTC MRAC CCP Risk and Governance Subcommittee, Recommendations Regarding CCP Margin Methodologies (12 February 2021). Our members also contributed to a 2020 industry whitepaper that provides specific recommendations from end-users and clearing members to enhance CCPs' resilience. A Path Forward for CCP Resilience, Recovery and Resolution (March 10, 2020) (2020 Industry Whitepaper).

We support many of the recent proposals. Across the cleared and non-centrally cleared markets, the increased transparency that these proposals seek to effect could help regulated funds and other market participants better prepare for future market stress events. In particular, we note the importance of the work to enhance the transparency and responsiveness of IM in cleared markets, since the transparency issues in cleared markets have been difficult to overcome. See ICI Phase 1 Margin Letter; Letter from Annette Capretta to BCBS, CPMI, and IOSCO Secretariats re Consultative Report on Transparency and Responsiveness of Initial Margin in Centrally Cleared Markets (15 April 2024); Letter from Annette Capretta to BCBS and IOSCO Secretariat re Streamlining VM processes and IM responsiveness of margin models in non-centrally cleared markets (15 April 2024); Letter from Annette Capretta to CPMI and IOSCO Secretariats re Streamlining variation margin in centrally cleared markets – examples of effective practices (15 April 2024).

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

We agree with the Consultation's proposal to apply the recommendations proportionately. A one-size-fits-all approach would not be appropriate, since the recommendations are intended to apply to a broad scope of market participants, across many sectors, engaged in different activities, and subject to different levels of regulations. While the Consultation presents several considerations that are intended to relate to the materiality of the potential risks, the approach should be revised to add existing liquidity risk management regulations as a factor and clarify that the materiality of risks should be considered holistically.

a. Existing liquidity risk management frameworks should be considered when determining the materiality of potential risks

We agree with the Consultation that the proportionate application of the recommendations must be tied to the materiality of the potential liquidity risks arising from exposures to spikes in margin and collateral calls. See Consultation at 11-12. Such risks are not homogenous across non-bank market participants.

Indeed, the Consultation recognises that some non-bank market participants are already subject to robust liquidity management frameworks and these frameworks mitigate the potential for liquidity risks that can arise following spikes in margin and collateral calls. Id. at 9.

For example, regulated funds in many jurisdictions are subject to robust regulatory and supervisory frameworks that require or address, among others: limits on leverage and borrowing; derivatives risk management; liquidity risk management; conflicts; extensive disclosures (including with regard to risk and investments); custody; mark-to-market valuation of assets and NAV calculation; and investment restrictions or limitations (e.g., "eligible assets," concentration and/or diversification). These frameworks require regulated funds to establish and maintain documented risk guidelines, perform stress testing and backtesting, and report and escalate concerns internally and to regulators. Together, these requirements limit a fund's exposure to risks, such as those associated with undue speculation, and help regulated funds maintain sufficient assets to meet their obligations.

The report, therefore, should be revised to clarify that as jurisdictions determine how to proportionately apply the recommendations, they should consider the potential risks in light of existing liquidity risk management regulations.

b. The materiality of risks should be considered holistically

In the Consultation, the FSB proposes several factors that jurisdictions should weigh when determining how to proportionately apply the recommendations to firms that present material risks. These factors include an entity's size, organisational structure, international footprint, complexity of activities, and activity in the derivatives and securities markets in which the entity operates, with other considerations including liquidity risk profile, leverage, and funding mismatches.

Any one of these considerations may not provide insight into the materiality of potential liquidity risks. For example, size is not definitively related to the materiality of a firm's liquidity risk. A large, highly regulated investment management firm that operates on a global basis, invests primarily in liquid assets on behalf of its clients, and does not extensively use derivatives may not present material risks. In contrast, a small firm that is an active derivatives user, does not engage in complex activities, and does not have an extensive international footprint may nevertheless pose a risk to the financial system, particularly where such a firm is subject to little or no regulation and oversight. Indeed, in prior work, the FSB has concluded that there is a particular need to monitor the preparedness of less regulated firms to manage sudden increases in margin. FSB, The Financial Stability Aspects of Commodities Markets (20 February 2023) at 26.

Accordingly, a more effective approach would revise the report to clarify that materiality should be holistically considered because individual factors, such as size, are not clear indicators of the materiality of liquidity risks.

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?**

We are generally supportive of the goals underlying the Consultation's recommendations, which describe high-level principles that can be applied across the broad scope of market participants that are intended to be covered.

The explanatory text, in contrast, is more prescriptive in describing how market participants can implement the recommendations. In several places, the explanatory text proposes that market participants consider factors that are unfeasible and makes assumptions that are not appropriate for the broad scope of market participants covered by the Consultation.

Given the diversity of non-bank market participants, a more effective approach is to be less prescriptive in the explanatory text. Providing more flexibility can enhance the feasibility of implementing the recommendations and reaching the goals that the FSB seeks to achieve.

Recommendation 2

Recommendation 2 in the Consultation states that "…market participants should define their appetite for liquidity risk arising from margin and collateral calls and establish contingency funding plans to ensure that liquidity needs arising from these calls can be met, including under extreme but plausible stressed conditions." Consultation at 13. In the explanatory guidance, the FSB further sets forth that in establishing contingency funding plans, market participants "…where possible, should also take into consideration the risk management practices of their counterparties…" Id. at 14.

While we appreciate the outcome that the FSB is seeking – i.e., that market participants consider their counterparty risks across cleared and non-centrally cleared markets – we note that market participants do not have and cannot get access to their counterparties' risk management practices. As noted above, in cleared markets, information regarding central counterparty (CCP) margin practices has proven difficult to obtain and is the subject of international work. It is also not feasible to obtain risk management practices from other counterparties because of the commercial sensitivity of such information.

We suggest that the FSB revise the text in all places (similar explanatory text appears under Recommendations 1, 3, and 8) to eliminate the recommendation that market participants should take into consideration the risk management practices of their counterparties. Instead, the explanatory text could more flexibly recommend that market participants consider counterparty risks through information they have, such as observations of counterparty behaviour in stressed conditions and the results of credit and liquidity monitoring of their counterparties.

Recommendation 3

We support Recommendation 3 in the Consultation, which states "…market participants should regularly review and update their liquidity risk management framework to ensure that liquidity risks arising from margin and collateral calls are robustly managed and mitigated, particularly under extreme but plausible stress scenarios." Consultation at 14. In the explanatory guidance, the FSB notes, with which we agree, that "…available information varies across asset classes and transparency of certain market positions can be limited…" Id. However, the FSB further explains that "it is important that market participants actively seek information, or consider alternative means of accessing data, to close any data gaps to improve their liquidity risk management." Id.

We appreciate the FSB's goal, that market participants have access to critical information to enhance their liquidity preparedness. We caution, however, that market participants may be unable to obtain data relevant to liquidity risk management when that information sits outside of their control. For example, for many years, market participants have sought greater transparency from CCPs regarding margin practices. Some CCPs have been reluctant to provide additional transparency into their margin practices because they believe their margin models reflect valuable and unique business strategies or have disclosed such information with long lag times that diminish the information's value.

Accordingly, prescriptive guidance that puts the onus on market participants to close data gaps is not likely to achieve the FSB's goal of increasing access to information. We suggest that the FSB revise the text to reflect that, although market participants may make efforts to seek the information, they may not be successful in doing so, because they do not control or have access to the information.

Recommendation 3 in the Consultation also provides that market participants should "regularly ... take into consideration how the risk management practices of their counterparties may respond, in particular in stressed market conditions." Id. Given that, as explained above, market participants do not have and cannot get access to their counterparties' risk management practices, this recommendation is overly prescriptive. Moreover, interpretations of this recommendation may vary across jurisdictions, which could unnecessarily complicate liquidity risk management practices, since insight into a given counterparty's risk management practices would be incomplete at best.

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

We are generally supportive of the goals underlying the Consultation's recommendations, which describe high-level principles that can be applied across the broad scope of market participants that are intended to be covered.

The explanatory text, in contrast, is more prescriptive in describing how market participants can implement the recommendations. In several places, the explanatory text proposes that market participants consider factors that are unfeasible and makes assumptions that are not appropriate for the broad scope of market participants covered by the Consultation.

Given the diversity of non-bank market participants, a more effective approach is to be less prescriptive in the explanatory text. Providing more flexibility can enhance the feasibility of implementing the recommendations and reaching the goals that the FSB seeks to achieve.

Recommendation 4

We support the overarching objective of Recommendation 4, namely "to identify sources of potential liquidity strains caused by margin and collateral calls, and to ensure a level of resilience consistent with their established liquidity risk appetite." Consultation at 15. However, a formal and prescriptive stress testing requirement is not the sole means by which a market participant may achieve that objective.

As the Consultation correctly notes, not all market participants are subject to mandatory stress testing regulations or detailed requirements. Formal stress testing may not be needed for entities with low liquidity risk or otherwise subject to adequate regulatory requirements. See, e.g., Rule 18f-4(c)(4) under the Investment Company Act (excluding "limited derivatives users" from the rule's stress testing requirements). See also Rule 22e-4 under the Investment Company Act, which, among many other things, requires a US registered open-end fund to assess, manage, and periodically review its liquidity risk, considering factors such as (i) its investment strategy and liquidity of portfolio investments during both normal and reasonably foreseeable stressed conditions, including the use of borrowings for investment purposes and derivatives, and (ii) its short-term and long-term cash flow projections during both normal and reasonably foreseeable stressed conditions.

Similarly, it is not appropriate to generally expect all non-bank market participants to "include scenarios that use historical data as well as hypothetical forward-looking stress scenarios and reverse stress testing." Consultation at 15. For instance, for many registered open-end funds, the starting point of a reverse stress test—the assumed failure of the fund to meet redemptions and/or margin and collateral calls—is simply not realistic, even under "extreme but plausible scenarios."

It also may not be appropriate to generally expect that "stress tests … be conducted at an aggregate level (e.g., based on collective exposure of all funds managed by the same market participant)…" Id. at 15-16. Often, stress testing of a single entity only (i.e., a single fund) is more appropriate, since funds are discrete legal entities, with discrete assets and liabilities, and unique liquidity profiles and investor bases. Letter from Paul Schott Stevens to the Secretariat of the Financial Stability Board re Consultative Document, Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities (21 Sept. 2016) (FSB 2016 Letter).

We therefore recommend modifying this text to provide a market participant with more flexibility to "assess and identify" (rather than conduct liquidity stress tests) "sources of potential liquidity strains…," which may or may not be accomplished through stress testing, while removing the prescriptive expectations about how any stress test should be conducted. Cf. Recommendation 14 from IOSCO's Recommendations for Liquidity Risk Management for Collective Investment Schemes (February 2018) ("The responsible entity should conduct ongoing liquidity assessments in different scenarios, which could include fund level stress testing, in line with regulatory guidance.").

Recommendation 5

Recommendation 5 in the Consultation states that "…robust stress testing should analyse a range of extreme but plausible liquidity stresses caused by changes in margin and collateral calls, as well as market participants' overall liquidity position." Consultation at 16. In the accompanying text, the FSB also states that "…market participants should also consider whether they participate in crowded strategies or concentrated market segments and are therefore more prone to liquidating the same assets at the same time as other market participants." Id. at 17.

We understand that the FSB wants to address concerns that market participants do not act in a vacuum in response to market stresses and ensure that market participants' stress tests consider market dynamics.

However, we caution that market participants may have limited or no insight into other market participants' holdings (e.g., whether a strategy is "crowded"), much less how those other market participants are likely to respond to stress. For an entity to project how it will respond to hypothetical scenarios already presents challenges and requires the entity to make a number of assumptions. To expand the requirements beyond the entity's own response would greatly increase the complexity and subjectivity of the exercise, rendering the results far more speculative. See FSB 2016 Letter.

We recommend that the FSB revise this text so that it does not prescribe specific considerations that market participants should include in stress tests. Rather, to address the concerns that market participants consider market dynamics, the text should be revised to focus on the information that a market participant has at hand, rather than requiring potentially uninformed speculation of what other parties may do (which may already be captured in the stressed scenario where a market participant is conducting a stress test).

The explanatory text for Recommendation 5 also proposes that "market participants should conduct, where applicable, a liquidation cost analysis for the proportion of the portfolio expected to be hedged, liquidated, or unwound as a result of a relevant stress scenario…." Consultation at 17. The text further provides that "market participants should consider the resulting liquidity profile of the post-liquidation portfolio, particularly when liquidating only the most liquid assets rather than a pro-rata cross section of the portfolio" when determining the portion of the portfolio to be liquidated. Id.

This text also seems to address the FSB's concerns that market participants consider market dynamics. However, the text would require market participants to provide additional justification for liquidation strategies that do not involve selling a pro-rata cross slice of the portfolio. This implies that selling a pro-rata slice of the portfolio is a preferable, more appropriate, or less risky strategy.

Consistent with a fund's objective, strategies, and policies, an adviser of an actively managed fund generally has more discretion in deciding which portfolio investments to buy, hold, and sell. Actively managed funds therefore are fluid in their composition. And even an index fund (i.e., funds that seek to track the performance of their target indexes) periodically rebalances and in any event may not seek or obtain precise replication of its index (i.e., the fund's holdings and their relative proportions may not exactly match the index's components and their relative proportions) due to certain other considerations (e.g., transaction costs, liquidity considerations, number of index components). Strictly speaking, even an index fund often will not buy or sell portfolio holdings pro rata in response to fund flows.

Assuming that selling a pro-rata slice of the portfolio is preferable inaccurately presumes that (i) funds maintain (or ought to maintain) fixed portfolios and transact accordingly, and (ii) there is a rigid relationship between daily flows and portfolio transactions. Moreover, in practice such a pro rata approach may be sub-optimal. Less liquid assets may sell at lower values during market stress and at higher values once the stress has ended. Conversely, liquid assets may sell at a premium (or hold their value) during market stress. Pro rata selling, therefore, could cause a fund to lock in losses when certain markets are temporarily depressed. Also, rigidly selling multiple small positions to create a pro rata vertical slice can be less efficient than other approaches and increase transaction costs.

The explanatory text should be revised to remove any suggestion that that there is a "right" way or a less risky way to buy or sell portfolio investments. Regulated funds vary too much in their investment objectives, strategies, and underlying portfolio assets for rigid portfolio management assumptions to be workable or desirable.

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

Regulated funds in many jurisdictions are subject to robust regulatory and supervisory frameworks that require or address, among others: limits on leverage and borrowing; derivatives risk management; liquidity risk management; conflicts; extensive disclosures (including with regard to risk and investments); custody; mark-to-market valuation of assets and NAV calculation; and investment restrictions or limitations (e.g., "eligible assets," concentration and/or diversification). These frameworks require regulated funds to establish and maintain documented risk guidelines, perform stress testing and backtesting, and report and escalate concerns internally and to regulators. Together, these requirements limit a fund's exposure to risks, such as those associated with undue speculation, and help regulated funds maintain sufficient assets to meet their obligations.

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?**

We are generally supportive of the goals underlying the Consultation's recommendations, which describe high-level principles that can be applied across the broad scope of market participants that are intended to be covered.

The explanatory text, in contrast, is more prescriptive in describing how market participants can implement the recommendations. In several places, the explanatory text proposes that market participants consider factors that are unfeasible and makes assumptions that are not appropriate for the broad scope of market participants covered by the Consultation.

Given the diversity of non-bank market participants, a more effective approach is to be less prescriptive in the explanatory text. Providing more flexibility can enhance the feasibility of implementing the recommendations and reaching the goals that the FSB seeks to achieve.

Recommendation 6

Recommendation 6 in the Consultation sets forth that "[m]arket participants should have resilient and effective operational processes and collateral management practices." Consultation at 17. In the explanatory text, the Consultation further indicates that "[m]arket participants should have a clear understanding of which counterparties can require intraday margin calls, which kinds of exposures and circumstances can lead to such calls, and whether the calls can be recurrent or ad hoc." Id.

We agree that market participants should have this clear understanding of intraday margin calls. In the cleared markets, we generally support the work of the Bank of International Settlement's Committee on Payment and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) work in this area, however, we remain concerned that under the recent proposal, central counterparties (CCPs) retain significant discretion to use ad hoc margin calls. Ad hoc intraday margin calls are unpredictable and the triggers for such calls are unclear. Under existing frameworks and even under the current proposal, end-users, including regulated funds, cannot adequately prepare for intraday margin calls because of the lack of transparency, which may increase operational and liquidity risk.

To address and mitigate these risks, CCPs' discretion to use ad hoc margin calls should be strictly constrained. In response to CPMI-IOSCO's recent consultation we recommended that CPMI-IOSCO address these concerns through additional guidance that: sets forth specific guidelines for adopting transparent thresholds or timeframes for scheduled intraday calls; pre-defines margin deficit thresholds that must be reached before a CCP may use an ad hoc call; and restricts the application of ad hoc calls to participants of relevant clearing services. Streamlining variation margin in centrally cleared markets – examples of effective practices (14 February 2024); Letter from Annette

Capretta to CPMI and IOSCO Secretariats re Streamlining variation margin in centrally cleared markets – examples of effective practices (15 April 2024).

We therefore suggest that the explanatory text of Recommendation 6 be revised to clarify that market participants cannot adequately prepare for ad hoc intraday CCP margin calls where CCPs retain significant discretion to use such calls. The text may also recommend that CCPs' discretion to use ad hoc margin calls must be strictly constrained to enhance market participants' liquidity preparedness.

Recommendation 7

Recommendation 7 states that "market participants should maintain sufficient levels of cash and readily available" collateral to meet margin and collateral calls. Consultation at 18. The explanatory text provides that the collateral should be pre-positioned and that market participants should set the levels of maintained collateral with a "high degree of certainty." Id. While we appreciate the regulatory goals that market participants should monitor their exposures and manage their resources in a manner that enables them to timely meet margin and collateral calls, we have several concerns.

Margin is, by definition, pre-positioned collateral that is held to mitigate risks. Recommendation 7 essentially layers an additional margin requirement on market participants, raising the margin floor. To meet this recommendation, market participants would need to commit more liquid resources, which would, contrary to the FSB's objective, increase the potential for liquidity strains during times of market stress. The additional layer of margin would represent a significant cost to market participants that would decrease efficiencies, create a drag on returns on investments, and reduce the opportunity for investment in the real economy. Market participants, including regulated funds, would need to reconsider their strategies, as higher costs could impact the economic viability of hedging arrangements. These costs would be incurred without a commensurate benefit, since the additional margin would not be appropriately calibrated to mitigate risks at a given point in time.

In addition, as noted above, we have fundamental concerns regarding the certainty and predictability of margin and collateral calls. Individual market participants' ability to model and predict the size of margin calls is dependent on assessments of what future market conditions could plausibly be and/or behaviours of other market participants or intermediaries. In the cleared markets, the problem is particularly acute, and we have highlighted the potential for policymakers' efforts to enhance transparency to also enhance market participants' liquidity preparedness. With other counterparties, it is difficult to obtain information regarding risk management practices because of the commercial sensitivity of such information. We are therefore concerned that it is not feasible for market participants to set a value with the FSB's expected level of certainty for the additional margin layer.

To address these concerns, we recommend eliminating references to pre-positioning collateral and expectations that market participants will set levels of maintained collateral with a high degree of certainty. A more effective approach would focus Recommendation 7 on market participants having and maintaining appropriate collateral management practices.

We appreciate the FSB's concerns that unanticipated margin and collateral calls can have significant liquidity impacts. Ensuring that firms have flexibility to react when liquidity is scarce could address these concerns. For example, expanding the types of eligible collateral could provide significant benefits, particularly in periods of market stress. We also encourage the FSB and other policymakers to engage in additional policy work on modernising the market structure for liquidity supply.

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

We appreciate the FSB's concerns that unanticipated margin and collateral calls can have significant liquidity impacts. Ensuring that firms have flexibility to react when liquidity is scarce could address these concerns. For example, expanding the types of eligible collateral could provide significant benefits, particularly in periods of market stress. We also encourage the FSB and other policymakers to engage in additional policy work on modernising the market structure for liquidity supply.

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

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18 June 2024

Financial Stability Board
Centralbahnplatz 2
Basel CH-4002
Switzerland

Submitted electronically in response to online form

Re: *Liquidity Preparedness for Margin Calls*

Dear Financial Stability Board Secretariat:

ICI Global[1] appreciates the opportunity to provide comments on the Financial Stability Board's (FSB) consultation on Liquidity Preparedness for Margin and Collateral Calls.[2] We offer comments based on the perspective of our members, regulated funds,[3] which are among the non-bank market participants included within the scope of the FSB's recommendations but which are subject to different regulatory requirements and engaged in different activities than other non-bank market participants. Our members use centrally cleared products in a variety of ways to implement their investment strategies[4] and exchange margin bilaterally for non-centrally cleared products.

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[1] ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated investment funds. With total assets of $43.5 trillion, ICI's membership includes mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in Europe, Asia, and other jurisdictions. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. ICI Global has offices in Brussels, London, and Washington, DC.

[2] FSB, Liquidity Preparedness for Margin and Collateral Calls: Consultation report (17 April 2024) (the Consultation).

[3] For purposes of this letter, the term "regulated fund" refers to any fund that is organised, formed, and regulated under national law, and is authorised for public sale. Such funds typically are subject to substantive regulation in areas such as disclosure, form of organisation, custody, minimum capital, valuation, investment restrictions (*e.g.*, leverage, types of investments or "eligible assets," concentration limits and/or diversification standards). Examples of such funds include US investment companies regulated under the Investment Company Act of 1940 and European Union (EU) and United Kingdom (UK) UCITS.

[4] Derivatives, including those that are centrally cleared, offer regulated funds considerable flexibility in structuring their investment portfolios. These uses include hedging positions, more efficiently deploying cash that a regulated fund cannot immediately invest in direct security holdings, managing a regulated fund's cash position more generally, and adjusting duration.

We appreciate the work of the Basel Committee on Banking Supervision (BCBS), the Bank of International Settlement's Committee for Payment and Market Infrastructures (CPMI), and the International Organization for Securities Commissions (IOSCO) in reviewing margining practices in centrally and non-centrally cleared markets, which led to recent proposals,[5] and the recommendation that the FSB undertake additional international work to enhance liquidity preparedness of non-bank market participants, the subject of this Consultation.

As discussed more fully below, we support efforts to enhance transparency and governance of margin practices and are supportive of the recent BCBS-CPMI-IOSCO proposals.[6] We also are generally supportive of the goals underlying the Consultation's recommendations, but certain parts of the report should be clarified to reflect important considerations related to the regulated funds sector. Specifically, the approach to determining the materiality of risks should be modified to add existing liquidity risk management requirements as a factor and to clarify that materiality of risks should be considered holistically. In addition, we recommend that the explanatory text related to certain of the recommendations be revised to provide more flexibility for market participants, such as regulated funds.

1. Efforts to increase transparency can enhance liquidity preparedness

Although regulated funds were able to meet margin calls during the unprecedented market stress during March 2020, we believe that increased transparency could help regulated funds and other market participants to better prepare for future market stress events and mitigate the challenges associated with meeting unexpected margin calls.

In March 2020, the overwhelming majority of regulated funds, including US-domiciled regulated funds, continued to function normally and redeem shares upon demand. Consistent with their normal operations, regulated funds also continued to meet their margin calls. As BCBS-CPMI-IOSCO concluded, more than 93 percent of clients, including all regulated funds, met margin calls on the day they were due, with no significant changes in these figures across February, March, and April 2020.[7] Through robust liquidity risk management programmes, internal stress testing, and the flexibility to use a range of liquidity and liability management tools, regulated

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[5] BCBS-CPMI-IOSCO, Review of margining practices (29 September 2022) (Margin Review); BCBS-CPMI-IOSCO, Transparency and responsiveness of initial margin in centrally cleared markets – review and policy proposals – Consultative report (16 January 2024); BCBS-IOSCO, Streamlining VM processes and IM responsiveness of margin models in non-centrally cleared markets (17 January 2024); CPMI-IOSCO, Streamlining variation margin in centrally cleared markets – examples of effective practices (14 February 2024) (CPMI-IOSCO Cleared VM Consultation).

[6] *See* Letter from Annette Capretta to BCBS, CPMI, and IOSCO Secretariats re Consultative Report on Transparency and Responsiveness of Initial Margin in Centrally Cleared Markets (15 April 2024) (ICI Cleared IM Response); Letter from Annette Capretta to BCBS and IOSCO Secretariat re Streamlining VM processes and IM responsiveness of margin models in non-centrally cleared markets (15 April 2024) (ICI Non-Centrally Cleared Response); Letter from Annette Capretta to CPMI and IOSCO Secretariats re Streamlining variation margin in centrally cleared markets – examples of effective practices (15 April 2024) (ICI Cleared VM Response).

[7] *See* Margin Review at 32.

funds were able to appropriately prepare for and meet redemption requests and ensure that margin calls were fully and timely paid.

Nevertheless, global regulators can improve margin practices in the derivatives and securities markets, by making margin collection more transparent and efficient to alleviate downstream stresses on the broader financial system.

Transparency of margin processes is critical to liquidity preparedness. The problem is particularly acute in cleared markets, where initial margin (IM) is the cornerstone of central counterparty (CCP) risk management, but the CCP methodologies for calculating cleared IM requirements are relatively opaque. As a result, end-users have unsuccessfully sought the transparency to anticipate and plan for changes. We agree with the Consultation that CCPs and intermediaries can play an important role in helping their clients better prepare for spikes in margin and collateral calls by providing transparency on their margining practices.[8]

To that end, ICI and its members have long supported efforts to enhance the transparency and governance of margin practices in cleared and non-centrally cleared markets.[9] We support many of the recent proposals. Across the cleared and non-centrally cleared markets, the increased transparency that these proposals seek to effect could help regulated funds and other market participants better prepare for future market stress events. In particular, we note the importance of the work to enhance the transparency and responsiveness of IM in cleared markets, since the transparency issues in cleared markets have been difficult to overcome.[10]

2. The approach to determining the materiality of potential risks should be revised

We agree with the Consultation's proposal to apply the recommendations proportionately.[11] A one-size-fits-all approach would not be appropriate, since the recommendations are intended to apply to a broad scope of market participants, across many sectors, engaged in different activities, and subject to different levels of regulations. While the Consultation presents several considerations that are intended to relate to the materiality of the potential risks, the approach

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[8] Consultation at 3.

[9] *See*, *e.g.,* Letter from Jennifer S. Choi to BCBS, CPMI, and IOSCO Secretariats re Consultative Report on Review of Margining Practices (26 January 2022) (ICI Phase 1 Margin Letter).

Notably, in their capacity as end-users, individual ICI members have contributed to several industry efforts to develop and offer sensible recommendations toward achieving these objectives, including as members of a key Commodity Futures Trading Commission (CFTC) Market Risk Advisory Committee (MRAC). *See, e.g.,* CFTC MRAC CCP Risk and Governance Subcommittee, Recommendations Regarding CCP Margin Methodologies (12 February 2021). Our members also contributed to a 2020 industry whitepaper that provides specific recommendations from end-users and clearing members to enhance CCPs' resilience. A Path Forward for CCP Resilience, Recovery and Resolution (March 10, 2020).

[10] *See* ICI Phase 1 Margin Letter; ICI Cleared IM Response; ICI Non-Centrally Cleared Response; ICI Cleared VM Response.

[11] Consultation at 11.

should be revised to add existing liquidity risk management regulations as a factor and clarify that the materiality of risks should be considered holistically.

a. Existing liquidity risk management frameworks should be considered when determining the materiality of potential risks

We agree with the Consultation that the proportionate application of the recommendations must be tied to the materiality of the potential liquidity risks arising from exposures to spikes in margin and collateral calls.[12] Such risks are not homogenous across non-bank market participants.

Indeed, the Consultation recognises that some non-bank market participants are already subject to robust liquidity management frameworks[13] and these frameworks mitigate the potential for liquidity risks that can arise following spikes in margin and collateral calls.

For example, regulated funds in many jurisdictions are subject to robust regulatory and supervisory frameworks that require or address, among others: limits on leverage and borrowing; derivatives risk management; liquidity risk management; conflicts; extensive disclosures (including with regard to risk and investments); custody; mark-to-market valuation of assets and NAV calculation; and investment restrictions or limitations (*e.g.*, "eligible assets," concentration and/or diversification). These frameworks require regulated funds to establish and maintain documented risk guidelines, perform stress testing and backtesting, and report and escalate concerns internally and to regulators. Together, these requirements limit a fund's exposure to risks, such as those associated with undue speculation, and help regulated funds maintain sufficient assets to meet their obligations.

The report, therefore, should be revised to clarify that as jurisdictions determine how to proportionately apply the recommendations, they should consider the potential risks in light of existing liquidity risk management regulations.

b. The materiality of risks should be considered holistically

In the Consultation, the FSB proposes several factors that jurisdictions should weigh when determining how to proportionately apply the recommendations to firms that present material risks. These factors include an entity's size, organisational structure, international footprint, complexity of activities, and activity in the derivatives and securities markets in which the entity operates, with other considerations including liquidity risk profile, leverage, and funding mismatches.

Any one of these considerations may not provide insight into the materiality of potential liquidity risks. For example, size is not definitively related to the materiality of a firm's liquidity risk. A

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[12] *See id.* at 11-12.

[13] *Id.* at 9.

large, highly regulated investment management firm that operates on a global basis, invests primarily in liquid assets on behalf of its clients, and does not extensively use derivatives may not present material risks. In contrast, a small firm that is an active derivatives user, does not engage in complex activities, and does not have an extensive international footprint may nevertheless pose a risk to the financial system, particularly where such a firm is subject to little or no regulation and oversight. Indeed, in prior work, the FSB has concluded that there is a particular need to monitor the preparedness of less regulated firms to manage sudden increases in margin.[14]

Accordingly, a more effective approach would revise the report to clarify that materiality should be holistically considered because individual factors, such as size, are not clear indicators of the materiality of liquidity risks.

3. The explanatory text should provide more flexibility to market participants

We are generally supportive of the goals underlying the Consultation's recommendations, which describe high-level principles that can be applied across the broad scope of market participants that are intended to be covered.

The explanatory text, in contrast, is more prescriptive in describing how market participants can implement the recommendations. In several places, the explanatory text proposes that market participants consider factors that are unfeasible and makes assumptions that are not appropriate for the broad scope of market participants covered by the Consultation.

Given the diversity of non-bank market participants, a more effective approach is to be less prescriptive in the explanatory text. Providing more flexibility can enhance the feasibility of implementing the recommendations and reaching the goals that the FSB seeks to achieve. We suggest several such modifications to the explanatory text below.

Recommendation 2

Recommendation 2 in the Consultation states that "…market participants should define their appetite for liquidity risk arising from margin and collateral calls and establish contingency funding plans to ensure that liquidity needs arising from these calls can be met, including under extreme but plausible stressed conditions."[15] In the explanatory guidance, the FSB further sets forth that in establishing contingency funding plans, market participants "…where possible, should also take into consideration the risk management practices of their counterparties…"[16]

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[14] FSB, The Financial Stability Aspects of Commodities Markets (20 February 2023) at 26.

[15] Consultation at 13.

[16] *Id.* at 14.

While we appreciate the outcome that the FSB is seeking – *i.e.*, that market participants consider their counterparty risks across cleared and non-centrally cleared markets – we note that market participants do not have and cannot get access to their counterparties' risk management practices. As noted above, in cleared markets, information regarding CCP margin practices has proven difficult to obtain and is the subject of international work. It is also not feasible to obtain risk management practices from other counterparties because of the commercial sensitivity of such information.

We suggest that the FSB revise the text in all places[17] to eliminate the recommendation that market participants should take into consideration the risk management practices of their counterparties. Instead, the explanatory text could more flexibly recommend that market participants consider counterparty risks through information they have, such as observations of counterparty behaviour in stressed conditions and the results of credit and liquidity monitoring of their counterparties.

Recommendation 3

We support Recommendation 3 in the Consultation, which states "…market participants should regularly review and update their liquidity risk management framework to ensure that liquidity risks arising from margin and collateral calls are robustly managed and mitigated, particularly under extreme but plausible stress scenarios."[18] In the explanatory guidance, the FSB notes, with which we agree, that "…available information varies across asset classes and transparency of certain market positions can be limited…"[19] However, the FSB further explains that "it is important that market participants actively seek information, or consider alternative means of accessing data, to close any data gaps to improve their liquidity risk management."[20]

We appreciate the FSB's goal, that market participants have access to critical information to enhance their liquidity preparedness. We caution, however, that market participants may be unable to obtain data relevant to liquidity risk management when that information sits outside of their control. For example, for many years, market participants have sought greater transparency from CCPs regarding margin practices. Some CCPs have been reluctant to provide additional transparency into their margin practices because they believe their margin models reflect valuable and unique business strategies or have disclosed such information with long lag times that diminish the information's value.

Accordingly, prescriptive guidance that puts the onus on market participants to close data gaps is not likely to achieve the FSB's goal of increasing access to information. We suggest that the FSB revise the text to reflect that, although market participants may make efforts to seek the

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[17] Similar explanatory text appears under Recommendations 1, 3, and 8.

[18] Consultation at 14.

[19] *Id*.

[20] *Id*.

information, they may not be successful in doing so, because they do not control or have access to the information.

Recommendation 3 in the Consultation also provides that market participants should "regularly ... take into consideration how the risk management practices of their counterparties may respond, in particular in stressed market conditions."[21] Given that, as explained above, market participants do not have and cannot get access to their counterparties' risk management practices, this recommendation is overly prescriptive. Moreover, interpretations of this recommendation may vary across jurisdictions, which could unnecessarily complicate liquidity risk management practices, since insight into a given counterparty's risk management practices would be incomplete at best.

Recommendation 4

We support the overarching objective of Recommendation 4, namely "to identify sources of potential liquidity strains caused by margin and collateral calls, and to ensure a level of resilience consistent with their established liquidity risk appetite."[22] However, a formal and prescriptive stress testing requirement is not the sole means by which a market participant may achieve that objective.

As the Consultation correctly notes, not all market participants are subject to mandatory stress testing regulations or detailed requirements. Formal stress testing may not be needed for entities with low liquidity risk or otherwise subject to adequate regulatory requirements.[23]

Similarly, it is not appropriate to generally expect all non-bank market participants to "include scenarios that use historical data as well as hypothetical forward-looking stress scenarios and reverse stress testing."[24] For instance, for many registered open-end funds, the starting point of a reverse stress test—the assumed failure of the fund to meet redemptions and/or margin and collateral calls—is simply not realistic, even under "extreme but plausible scenarios."

It also may not be appropriate to generally expect that "stress tests … be conducted at an aggregate level (*e.g.*, based on collective exposure of all funds managed by the same market participant)…"[25] Often, stress testing of a single entity only (*i.e.*, a single fund) is more

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[21] *Id*.

[22] *Id.* at 15.

[23] *See, e.g.*, Rule 18f-4(c)(4) under the Investment Company Act (excluding "limited derivatives users" from the rule's stress testing requirements). *See also* Rule 22e-4 under the Investment Company Act, which, among many other things, requires a US registered open-end fund to assess, manage, and periodically review its liquidity risk, considering factors such as (i) its investment strategy and liquidity of portfolio investments during both normal and reasonably foreseeable stressed conditions, including the use of borrowings for investment purposes and derivatives, and (ii) its short-term and long-term cash flow projections during both normal and reasonably foreseeable stressed conditions.

[24] Consultation at 15.

[25] *Id*.

appropriate, since funds are discrete legal entities, with discrete assets and liabilities, and unique liquidity profiles and investor bases.[26]

We therefore recommend modifying this text to provide a market participant with more flexibility to "assess and identify" (rather than conduct liquidity stress tests) "sources of potential liquidity strains…," which may or may not be accomplished through stress testing, while removing the prescriptive expectations about how any stress test should be conducted.[27]

Recommendation 5

Recommendation 5 in the Consultation, which states that "…robust stress testing should analyse a range of extreme but plausible liquidity stresses caused by changes in margin and collateral calls, as well as market participants' overall liquidity position."[28] In the accompanying text, the FSB also states that "…market participants should also consider whether they participate in crowded strategies or concentrated market segments and are therefore more prone to liquidating the same assets at the same time as other market participants."[29]

We understand that the FSB wants to address concerns that market participants do not act in a vacuum in response to market stresses and ensure that market participants' stress tests consider market dynamics.

However, we caution that market participants may have limited or no insight into other market participants' holdings (*e.g.*, whether a strategy is "crowded"), much less how those other market participants are likely to respond to stress. For an entity to project how it will respond to hypothetical scenarios already presents challenges and requires the entity to make a number of assumptions. To expand the requirements beyond the entity's own response would greatly increase the complexity and subjectivity of the exercise, rendering the results far more speculative.[30]

We recommend that the FSB revise this text so that it does not prescribe specific considerations that market participants should include in stress tests. Rather, to address the concerns that market participants consider dynamics, the text should be revised to focus on the information that a market participant has at hand, rather than requiring potentially uninformed speculation of what

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[26] Letter from Paul Schott Stevens to the Secretariat of the Financial Stability Board re Consultative Document, Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities (21 Sept. 2016) (FSB 2016 Letter).

[27] *Cf.* Recommendation 14 from IOSCO's Recommendations for Liquidity Risk Management for Collective Investment Schemes (February 2018) ("The responsible entity should conduct ongoing liquidity assessments in different scenarios, which could include fund level stress testing, in line with regulatory guidance.").

[28] Consultation at 16.

[29] *Id.* at 17.

[30] *See* FSB 2016 Letter.

other parties may do (which may already be captured in the stressed scenario where a market participant is conducting a stress test).

The explanatory text for Recommendation 5 also proposes that "market participants should conduct, where applicable, a liquidation cost analysis for the proportion of the portfolio expected to be hedged, liquidated, or unwound as a result of a relevant stress scenario…."[31] The text further provides that "market participants should consider the resulting liquidity profile of the post-liquidation portfolio, particularly when liquidating only the most liquid assets rather than a pro-rata cross section of the portfolio" when determining the portion of the portfolio to be liquidated.[32]

This text also seems to address the FSB's concerns that market participants consider market dynamics. However, the text would require market participants to provide additional justification for liquidation strategies that do not involve selling a pro-rata cross slice of the portfolio. This implies that selling a pro-rata slice of the portfolio is a preferable, more appropriate, or less risky strategy.

Assuming that selling a pro-rata slice of the portfolio is preferable inaccurately presumes that (i) funds maintain (or ought to maintain) fixed portfolios and transact accordingly,[33] and (ii) there is a rigid relationship between daily flows and portfolio transactions. Moreover, in practice such a pro rata approach may be sub-optimal. Less liquid assets may sell at lower values during market stress and at higher values once the stress has ended. Conversely, liquid assets may sell at a premium (or hold their value) during market stress. Pro rata selling, therefore, could cause a fund to lock in losses when certain markets are temporarily depressed. Also, rigidly selling multiple small positions to create a pro rata vertical slice can be less efficient than other approaches and increase transaction costs.

The explanatory text should be revised to remove any suggestion that that there is a "right" way or a less risky way to buy or sell portfolio investments. Regulated funds vary too much in their investment objectives, strategies, and underlying portfolio assets for rigid portfolio management assumptions to be workable or desirable.

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[31] Consultation at 17.

[32] *Id*.

[33] Consistent with a fund's objective, strategies, and policies, an adviser of an actively managed fund generally has more discretion in deciding which portfolio investments to buy, hold, and sell. Actively managed funds therefore are fluid in their composition. And even an index fund (*i.e.*, funds that seek to track the performance of their target indexes) periodically rebalances and in any event may not seek or obtain precise replication of its index (*i.e.*, the fund's holdings and their relative proportions may not exactly match the index's components and their relative proportions) due to certain other considerations (*e.g.,* transaction costs, liquidity considerations, number of index components). Strictly speaking, even an index fund often will not buy or sell portfolio holdings pro rata in response to fund flows.

Recommendation 6

Recommendation 6 in the Consultation sets forth that "[m]arket participants should have resilient and effective operational processes and collateral management practices."[34] In the explanatory text, the Consultation further indicates that "[m]arket participants should have a clear understanding of which counterparties can require intraday margin calls, which kinds of exposures and circumstances can lead to such calls, and whether the calls can be recurrent or ad hoc."[35]

We agree that market participants should have this clear understanding of intraday margin calls. In the cleared markets, we generally support CPMI-IOSCO's work in this area, however, we remain concerned that under the recent proposal, CCPs retain significant discretion to use ad hoc margin calls. Ad hoc intraday margin calls are unpredictable and the triggers for such calls are unclear. Under existing frameworks and even under the current proposal, end-users, including regulated funds, cannot adequately prepare for intraday margin calls because of the lack of transparency, which may increase operational and liquidity risk.

To address and mitigate these risks, CCPs' discretion to use ad hoc margin calls should be strictly constrained. In response to CPMI-IOSCO's recent consultation we recommended that CPMI-IOSCO address these concerns through additional guidance that: sets forth specific guidelines for adopting transparent thresholds or timeframes for scheduled intraday calls; pre-defines margin deficit thresholds that must be reached before a CCP may use an ad hoc call; and restricts the application of ad hoc calls to participants of relevant clearing services.[36]

We therefore suggest that the explanatory text of Recommendation 6 be revised to clarify that market participants cannot adequately prepare for ad hoc intraday CCP margin calls where CCPs retain significant discretion to use such calls. The text may also recommend that CCPs' discretion to use ad hoc margin calls must be strictly constrained to enhance market participants' liquidity preparedness.

Recommendation 7

Recommendation 7 states that "market participants should maintain sufficient levels of cash and readily available" collateral to meet margin and collateral calls.[37] The explanatory text provides that the collateral should be pre-positioned and that market participants should set the levels of maintained collateral with a "high degree of certainty."[38] While we appreciate the regulatory

[34] Consultation at 17.

[35] *Id*.

[36] CPMI-IOSCO Cleared VM Consultation; ICI Cleared VM Response.

[37] Consultation at 18.

[38] *Id*.

goals that market participants should monitor their exposures and manage their resources in a manner that enables them to timely meet margin and collateral calls, we have several concerns.

Margin is, by definition, pre-positioned collateral that is held to mitigate risks. Recommendation 7 essentially layers an additional margin requirement on market participants, raising the margin floor. To meet this recommendation, market participants would need to commit more liquid resources, which would, contrary to the FSB's objective, increase the potential for liquidity strains during times of market stress. The additional layer of margin would represent a significant cost to market participants that would decrease efficiencies, create a drag on returns on investments, and reduce the opportunity for investment in the real economy. Market participants, including regulated funds, would need to reconsider their strategies, as higher costs could impact the economic viability of hedging arrangements. These costs would be incurred without a commensurate benefit, since the additional margin would not be appropriately calibrated to mitigate risks at a given point in time.

In addition, as noted above, we have fundamental concerns regarding the certainty and predictability of margin and collateral calls. Individual market participants' ability to model and predict the size of margin calls is dependent on assessments of what future market conditions could plausibly be and/or behaviours of other market participants or intermediaries. In the cleared markets, the problem is particularly acute, and we have highlighted the potential for policymakers' efforts to enhance transparency to also enhance market participants' liquidity preparedness. With other counterparties, it is difficult to obtain information regarding risk management practices because of the commercial sensitivity of such information. We are therefore concerned that it is not feasible for market participants to set a value with the FSB's expected level of certainty for the additional margin layer.

To address these concerns, we recommend eliminating references to pre-positioning collateral and expectations that market participants will set levels of maintained collateral with a high degree of certainty. A more effective approach would focus Recommendation 7 on market participants having and maintaining appropriate collateral management practices.

We appreciate the FSB's concerns that unanticipated margin and collateral calls can have significant liquidity impacts. Ensuring that firms have flexibility to react when liquidity is scarce could address these concerns. For example, expanding the types of eligible collateral could provide significant benefits, particularly in periods of market stress. We also encourage the FSB and other policymakers to engage in additional policy work on modernising the market structure for liquidity supply.

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We appreciate your consideration of ICI Global's comments. If you have questions or would like to discuss our comments further, please contact me or Kirsten Robbins at +1-202-326-5800.

Sincerely,

/s/ Annette Capretta

Annette Capretta
Chief Counsel
ICI Global

The following responses were submitted via online form. Please note that due to limitations of the online form, the text of the footnotes was included in the body of the responses.

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?**

No response provided.

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

The Consultation proposes to apply the FSB's recommendations to non-bank market participants which the FSB defines as all market participants that are not commercial banks or central counterparties.

We generally find the scope to be appropriate, but it is critical to bear in mind the diversity of non-bank market participants. As the Consultation acknowledges, "non-bank market participants represent a broad range of sectors, and their liquidity risk management needs and practices differ widely."[1] Some non-bank market participants are already subject to robust liquidity management frameworks and these frameworks mitigate the potential for liquidity risks that can arise following spikes in margin and collateral calls.

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?**

Although regulated funds were able to meet margin calls during the unprecedented market stress during March 2020, we believe that increased transparency could help regulated funds and other market participants to better prepare for future market stress events and mitigate the challenges associated with meeting unexpected margin calls.

In March 2020, the overwhelming majority of regulated funds, including US-domiciled regulated funds, continued to function normally and redeem shares upon demand. Consistent with their normal operations, regulated funds also continued to meet their margin calls. As the Basel Committee for Banking Supervision (BCBS), the Bank of International Settlement's Committee on Payment and Market Infrastructures (CPMI), and the International Organization of Securities Commissions (IOSCO) concluded, more than 93 percent of clients, including all regulated funds, met margin calls on the day they were due, with no significant changes in these figures across February, March, and April 2020.[2] Through robust liquidity risk management programmes,

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[1] Consultation at 11.

[2] *See* BCBS-CPMI-IOSCO, Review of margining practices (29 September 2022) at 32.

internal stress testing, and the flexibility to use a range of liquidity and liability management tools, regulated funds were able to appropriately prepare for and meet redemption requests and ensure that margin calls were fully and timely paid.

Nevertheless, global regulators can improve margin practices in the derivatives and securities markets, by making margin collection more transparent and efficient to alleviate downstream stresses on the broader financial system.

Transparency of margin processes is critical to liquidity preparedness. The problem is particularly acute in cleared markets, where initial margin (IM) is the cornerstone of central counterparty (CCP) risk management, but the CCP methodologies for calculating cleared IM requirements are relatively opaque. As a result, end-users have unsuccessfully sought the transparency to anticipate and plan for changes. We agree with the Consultation that CCPs and intermediaries can play an important role in helping their clients better prepare for spikes in margin and collateral calls by providing transparency on their margining practices.[3]

To that end, ICI and its members have long supported efforts to enhance the transparency and governance of margin practices in cleared and non-centrally cleared markets.[4] We support many of the recent proposals. Across the cleared and non-centrally cleared markets, the increased transparency that these proposals seek to effect could help regulated funds and other market participants better prepare for future market stress events. In particular, we note the importance of the work to enhance the transparency and responsiveness of IM in cleared markets, since the transparency issues in cleared markets have been difficult to overcome.[5]

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

We agree with the Consultation's proposal to apply the recommendations proportionately. A one-size-fits-all approach would not be appropriate, since the recommendations are intended to apply to a broad scope of market participants, across many sectors, engaged in different activities, and

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[3] Consultation at 3.

[4] *See*, *e.g.,* Letter from Jennifer S. Choi to BCBS, CPMI, and IOSCO Secretariats re Consultative Report on Review of Margining Practices (26 January 2022) (ICI Phase 1 Margin Letter).

Notably, in their capacity as end-users, individual ICI members have contributed to several industry efforts to develop and offer sensible recommendations toward achieving these objectives, including as members of a key Commodity Futures Trading Commission (CFTC) Market Risk Advisory Committee (MRAC). *See, e.g.,* CFTC MRAC CCP Risk and Governance Subcommittee, Recommendations Regarding CCP Margin Methodologies (12 February 2021). Our members also contributed to a 2020 industry whitepaper that provides specific recommendations from end-users and clearing members to enhance CCPs' resilience. A Path Forward for CCP Resilience, Recovery and Resolution (March 10, 2020) (2020 Industry Whitepaper).

[5] *See* ICI Phase 1 Margin Letter; Letter from Annette Capretta to BCBS, CPMI, and IOSCO Secretariats re Consultative Report on Transparency and Responsiveness of Initial Margin in Centrally Cleared Markets (15 April 2024); Letter from Annette Capretta to BCBS and IOSCO Secretariat re Streamlining VM processes and IM responsiveness of margin models in non-centrally cleared markets (15 April 2024); Letter from Annette Capretta to CPMI and IOSCO Secretariats re Streamlining variation margin in centrally cleared markets – examples of effective practices (15 April 2024).

subject to different levels of regulations. While the Consultation presents several considerations that are intended to relate to the materiality of the potential risks, the approach should be revised to add existing liquidity risk management regulations as a factor and clarify that the materiality of risks should be considered holistically.

a. Existing liquidity risk management frameworks should be considered when determining the materiality of potential risks

We agree with the Consultation that the proportionate application of the recommendations must be tied to the materiality of the potential liquidity risks arising from exposures to spikes in margin and collateral calls.[6] Such risks are not homogenous across non-bank market participants.

Indeed, the Consultation recognises that some non-bank market participants are already subject to robust liquidity management frameworks[7] and these frameworks mitigate the potential for liquidity risks that can arise following spikes in margin and collateral calls.

For example, regulated funds in many jurisdictions are subject to robust regulatory and supervisory frameworks that require or address, among others: limits on leverage and borrowing; derivatives risk management; liquidity risk management; conflicts; extensive disclosures (including with regard to risk and investments); custody; mark-to-market valuation of assets and NAV calculation; and investment restrictions or limitations (*e.g.*, "eligible assets," concentration and/or diversification). These frameworks require regulated funds to establish and maintain documented risk guidelines, perform stress testing and backtesting, and report and escalate concerns internally and to regulators. Together, these requirements limit a fund's exposure to risks, such as those associated with undue speculation, and help regulated funds maintain sufficient assets to meet their obligations.

The report, therefore, should be revised to clarify that as jurisdictions determine how to proportionately apply the recommendations, they should consider the potential risks in light of existing liquidity risk management regulations.

b. The materiality of risks should be considered holistically

In the Consultation, the FSB proposes several factors that jurisdictions should weigh when determining how to proportionately apply the recommendations to firms that present material risks. These factors include an entity's size, organisational structure, international footprint, complexity of activities, and activity in the derivatives and securities markets in which the entity operates, with other considerations including liquidity risk profile, leverage, and funding mismatches.

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Any one of these considerations may not provide insight into the materiality of potential liquidity risks. For example, size is not definitively related to the materiality of a firm's liquidity risk. A large, highly regulated investment management firm that operates on a global basis, invests primarily in liquid assets on behalf of its clients, and does not extensively use derivatives may not present material risks. In contrast, a small firm that is an active derivatives user, does not engage in complex activities, and does not have an extensive international footprint may nevertheless pose a risk to the financial system, particularly where such a firm is subject to little or no regulation and oversight. Indeed, in prior work, the FSB has concluded that there is a particular need to monitor the preparedness of less regulated firms to manage sudden increases in margin.[8]

Accordingly, a more effective approach would revise the report to clarify that materiality should be holistically considered because individual factors, such as size, are not clear indicators of the materiality of liquidity risks.

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?**

We are generally supportive of the goals underlying the Consultation's recommendations, which describe high-level principles that can be applied across the broad scope of market participants that are intended to be covered.

The explanatory text, in contrast, is more prescriptive in describing how market participants can implement the recommendations. In several places, the explanatory text proposes that market participants consider factors that are unfeasible and makes assumptions that are not appropriate for the broad scope of market participants covered by the Consultation.

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forth that in establishing contingency funding plans, market participants "…where possible, should also take into consideration the risk management practices of their counterparties…"[10]

While we appreciate the outcome that the FSB is seeking – *i.e.*, that market participants consider their counterparty risks across cleared and non-centrally cleared markets – we note that market participants do not have and cannot get access to their counterparties' risk management practices. As noted above, in cleared markets, information regarding central counterparty (CCP) margin practices has proven difficult to obtain and is the subject of international work. It is also not feasible to obtain risk management practices from other counterparties because of the commercial sensitivity of such information.

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valuable and unique business strategies or have disclosed such information with long lag times that diminish the information's value.

Accordingly, prescriptive guidance that puts the onus on market participants to close data gaps is not likely to achieve the FSB's goal of increasing access to information. We suggest that the FSB revise the text to reflect that, although market participants may make efforts to seek the information, they may not be successful in doing so, because they do not control or have access to the information.

Recommendation 3 in the Consultation also provides that market participants should "regularly ... take into consideration how the risk management practices of their counterparties may respond, in particular in stressed market conditions."[15] Given that, as explained above, market participants do not have and cannot get access to their counterparties' risk management practices, this recommendation is overly prescriptive. Moreover, interpretations of this recommendation may vary across jurisdictions, which could unnecessarily complicate liquidity risk management practices, since insight into a given counterparty's risk management practices would be incomplete at best.

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

We are generally supportive of the goals underlying the Consultation's recommendations, which describe high-level principles that can be applied across the broad scope of market participants that are intended to be covered.

The explanatory text, in contrast, is more prescriptive in describing how market participants can implement the recommendations. In several places, the explanatory text proposes that market participants consider factors that are unfeasible and makes assumptions that are not appropriate for the broad scope of market participants covered by the Consultation.

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Recommendation 4

We support the overarching objective of Recommendation 4, namely "to identify sources of potential liquidity strains caused by margin and collateral calls, and to ensure a level of resilience consistent with their established liquidity risk appetite."[16] However, a formal and prescriptive stress testing requirement is not the sole means by which a market participant may achieve that objective.

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[16] Consultation at 15.

As the Consultation correctly notes, not all market participants are subject to mandatory stress testing regulations or detailed requirements. Formal stress testing may not be needed for entities with low liquidity risk or otherwise subject to adequate regulatory requirements.[17]

Similarly, it is not appropriate to generally expect all non-bank market participants to "include scenarios that use historical data as well as hypothetical forward-looking stress scenarios and reverse stress testing."[18] For instance, for many registered open-end funds, the starting point of a reverse stress test—the assumed failure of the fund to meet redemptions and/or margin and collateral calls—is simply not realistic, even under "extreme but plausible scenarios."

It also may not be appropriate to generally expect that "stress tests … be conducted at an aggregate level (*e.g.*, based on collective exposure of all funds managed by the same market participant)…"[19] Often, stress testing of a single entity only (*i.e.*, a single fund) is more appropriate, since funds are discrete legal entities, with discrete assets and liabilities, and unique liquidity profiles and investor bases.[20]

We therefore recommend modifying this text to provide a market participant with more flexibility to "assess and identify" (rather than conduct liquidity stress tests) "sources of potential liquidity strains…," which may or may not be accomplished through stress testing, while removing the prescriptive expectations about how any stress test should be conducted.[21]

Recommendation 5

Recommendation 5 in the Consultation states that "…robust stress testing should analyse a range of extreme but plausible liquidity stresses caused by changes in margin and collateral calls, as well as market participants' overall liquidity position."[22] In the accompanying text, the FSB also states that "…market participants should also consider whether they participate in crowded

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[17] *See, e.g.*, Rule 18f-4(c)(4) under the Investment Company Act (excluding "limited derivatives users" from the rule's stress testing requirements). *See also* Rule 22e-4 under the Investment Company Act, which, among many other things, requires a US registered open-end fund to assess, manage, and periodically review its liquidity risk, considering factors such as (i) its investment strategy and liquidity of portfolio investments during both normal and reasonably foreseeable stressed conditions, including the use of borrowings for investment purposes and derivatives, and (ii) its short-term and long-term cash flow projections during both normal and reasonably foreseeable stressed conditions.

[18] Consultation at 15.

[19] *Id.* at 15-16.

[20] Letter from Paul Schott Stevens to the Secretariat of the Financial Stability Board re Consultative Document, Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities (21 Sept. 2016) (FSB 2016 Letter).

[21] *Cf.* Recommendation 14 from IOSCO's Recommendations for Liquidity Risk Management for Collective Investment Schemes (February 2018) ("The responsible entity should conduct ongoing liquidity assessments in different scenarios, which could include fund level stress testing, in line with regulatory guidance.").

[22] Consultation at 16.

strategies or concentrated market segments and are therefore more prone to liquidating the same assets at the same time as other market participants."[23]

We understand that the FSB wants to address concerns that market participants do not act in a vacuum in response to market stresses and ensure that market participants' stress tests consider market dynamics.

However, we caution that market participants may have limited or no insight into other market participants' holdings (*e.g.*, whether a strategy is "crowded"), much less how those other market participants are likely to respond to stress. For an entity to project how it will respond to hypothetical scenarios already presents challenges and requires the entity to make a number of assumptions. To expand the requirements beyond the entity's own response would greatly increase the complexity and subjectivity of the exercise, rendering the results far more speculative.[24]

We recommend that the FSB revise this text so that it does not prescribe specific considerations that market participants should include in stress tests. Rather, to address the concerns that market participants consider market dynamics, the text should be revised to focus on the information that a market participant has at hand, rather than requiring potentially uninformed speculation of what other parties may do (which may already be captured in the stressed scenario where a market participant is conducting a stress test).

The explanatory text for Recommendation 5 also proposes that "market participants should conduct, where applicable, a liquidation cost analysis for the proportion of the portfolio expected to be hedged, liquidated, or unwound as a result of a relevant stress scenario…."[25] The text further provides that "market participants should consider the resulting liquidity profile of the post-liquidation portfolio, particularly when liquidating only the most liquid assets rather than a pro-rata cross section of the portfolio" when determining the portion of the portfolio to be liquidated.[26]

This text also seems to address the FSB's concerns that market participants consider market dynamics. However, the text would require market participants to provide additional justification for liquidation strategies that do not involve selling a pro-rata cross slice of the portfolio. This implies that selling a pro-rata slice of the portfolio is a preferable, more appropriate, or less risky strategy.

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[23] *Id.* at 17.

[24] *See* FSB 2016 Letter.

[25] Consultation at 17.

[26] *Id*.

Assuming that selling a pro-rata slice of the portfolio is preferable inaccurately presumes that (i) funds maintain (or ought to maintain) fixed portfolios and transact accordingly,[27] and (ii) there is a rigid relationship between daily flows and portfolio transactions. Moreover, in practice such a pro rata approach may be sub-optimal. Less liquid assets may sell at lower values during market stress and at higher values once the stress has ended. Conversely, liquid assets may sell at a premium (or hold their value) during market stress. Pro rata selling, therefore, could cause a fund to lock in losses when certain markets are temporarily depressed. Also, rigidly selling multiple small positions to create a pro rata vertical slice can be less efficient than other approaches and increase transaction costs.

The explanatory text should be revised to remove any suggestion that that there is a "right" way or a less risky way to buy or sell portfolio investments. Regulated funds vary too much in their investment objectives, strategies, and underlying portfolio assets for rigid portfolio management assumptions to be workable or desirable.

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

Regulated funds in many jurisdictions are subject to robust regulatory and supervisory frameworks that require or address, among others: limits on leverage and borrowing; derivatives risk management; liquidity risk management; conflicts; extensive disclosures (including with regard to risk and investments); custody; mark-to-market valuation of assets and NAV calculation; and investment restrictions or limitations (*e.g.*, "eligible assets," concentration and/or diversification). These frameworks require regulated funds to establish and maintain documented risk guidelines, perform stress testing and backtesting, and report and escalate concerns internally and to regulators. Together, these requirements limit a fund's exposure to risks, such as those associated with undue speculation, and help regulated funds maintain sufficient assets to meet their obligations.

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?

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[27] Consistent with a fund's objective, strategies, and policies, an adviser of an actively managed fund generally has more discretion in deciding which portfolio investments to buy, hold, and sell. Actively managed funds therefore are fluid in their composition. And even an index fund (*i.e.*, funds that seek to track the performance of their target indexes) periodically rebalances and in any event may not seek or obtain precise replication of its index (*i.e.*, the fund's holdings and their relative proportions may not exactly match the index's components and their relative proportions) due to certain other considerations (*e.g.,* transaction costs, liquidity considerations, number of index components). Strictly speaking, even an index fund often will not buy or sell portfolio holdings pro rata in response to fund flows.

We are generally supportive of the goals underlying the Consultation's recommendations, which describe high-level principles that can be applied across the broad scope of market participants that are intended to be covered.

The explanatory text, in contrast, is more prescriptive in describing how market participants can implement the recommendations. In several places, the explanatory text proposes that market participants consider factors that are unfeasible and makes assumptions that are not appropriate for the broad scope of market participants covered by the Consultation.

Given the diversity of non-bank market participants, a more effective approach is to be less prescriptive in the explanatory text. Providing more flexibility can enhance the feasibility of implementing the recommendations and reaching the goals that the FSB seeks to achieve.

Recommendation 6

Recommendation 6 in the Consultation sets forth that "[m]arket participants should have resilient and effective operational processes and collateral management practices."[28] In the explanatory text, the Consultation further indicates that "[m]arket participants should have a clear understanding of which counterparties can require intraday margin calls, which kinds of exposures and circumstances can lead to such calls, and whether the calls can be recurrent or ad hoc."[29]

We agree that market participants should have this clear understanding of intraday margin calls. In the cleared markets, we generally support the work of the Bank of International Settlement's Committee on Payment and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) work in this area, however, we remain concerned that under the recent proposal, central counterparties (CCPs) retain significant discretion to use ad hoc margin calls. Ad hoc intraday margin calls are unpredictable and the triggers for such calls are unclear. Under existing frameworks and even under the current proposal, end-users, including regulated funds, cannot adequately prepare for intraday margin calls because of the lack of transparency, which may increase operational and liquidity risk.

To address and mitigate these risks, CCPs' discretion to use ad hoc margin calls should be strictly constrained. In response to CPMI-IOSCO's recent consultation we recommended that CPMI-IOSCO address these concerns through additional guidance that: sets forth specific guidelines for adopting transparent thresholds or timeframes for scheduled intraday calls; pre-defines margin

[28] Consultation at 17.

[29] *Id*.

deficit thresholds that must be reached before a CCP may use an ad hoc call; and restricts the application of ad hoc calls to participants of relevant clearing services.[30]

We therefore suggest that the explanatory text of Recommendation 6 be revised to clarify that market participants cannot adequately prepare for ad hoc intraday CCP margin calls where CCPs retain significant discretion to use such calls. The text may also recommend that CCPs' discretion to use ad hoc margin calls must be strictly constrained to enhance market participants' liquidity preparedness.

Recommendation 7

Recommendation 7 states that "market participants should maintain sufficient levels of cash and readily available" collateral to meet margin and collateral calls.[31] The explanatory text provides that the collateral should be pre-positioned and that market participants should set the levels of maintained collateral with a "high degree of certainty."[32] While we appreciate the regulatory goals that market participants should monitor their exposures and manage their resources in a manner that enables them to timely meet margin and collateral calls, we have several concerns.

Margin is, by definition, pre-positioned collateral that is held to mitigate risks. Recommendation 7 essentially layers an additional margin requirement on market participants, raising the margin floor. To meet this recommendation, market participants would need to commit more liquid resources, which would, contrary to the FSB's objective, increase the potential for liquidity strains during times of market stress. The additional layer of margin would represent a significant cost to market participants that would decrease efficiencies, create a drag on returns on investments, and reduce the opportunity for investment in the real economy. Market participants, including regulated funds, would need to reconsider their strategies, as higher costs could impact the economic viability of hedging arrangements. These costs would be incurred without a commensurate benefit, since the additional margin would not be appropriately calibrated to mitigate risks at a given point in time.

In addition, as noted above, we have fundamental concerns regarding the certainty and predictability of margin and collateral calls. Individual market participants' ability to model and predict the size of margin calls is dependent on assessments of what future market conditions could plausibly be and/or behaviours of other market participants or intermediaries. In the cleared markets, the problem is particularly acute, and we have highlighted the potential for policymakers' efforts to enhance transparency to also enhance market participants' liquidity preparedness. With other counterparties, it is difficult to obtain information regarding risk management practices because of the commercial sensitivity of such information. We are

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[30] Streamlining variation margin in centrally cleared markets – examples of effective practices (14 February 2024); Letter from Annette Capretta to CPMI and IOSCO Secretariats re Streamlining variation margin in centrally cleared markets – examples of effective practices (15 April 2024).

[31] Consultation at 18.

[32] *Id*.

therefore concerned that it is not feasible for market participants to set a value with the FSB's expected level of certainty for the additional margin layer.

To address these concerns, we recommend eliminating references to pre-positioning collateral and expectations that market participants will set levels of maintained collateral with a high degree of certainty. A more effective approach would focus Recommendation 7 on market participants having and maintaining appropriate collateral management practices.

We appreciate the FSB's concerns that unanticipated margin and collateral calls can have significant liquidity impacts. Ensuring that firms have flexibility to react when liquidity is scarce could address these concerns. For example, expanding the types of eligible collateral could provide significant benefits, particularly in periods of market stress. We also encourage the FSB and other policymakers to engage in additional policy work on modernising the market structure for liquidity supply.

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

We appreciate the FSB's concerns that unanticipated margin and collateral calls can have significant liquidity impacts. Ensuring that firms have flexibility to react when liquidity is scarce could address these concerns. For example, expanding the types of eligible collateral could provide significant benefits, particularly in periods of market stress. We also encourage the FSB and other policymakers to engage in additional policy work on modernising the market structure for liquidity supply.