Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Zeist, 18 June 2024

Dear madam/sir,

We welcome the opportunity to respond to the FSB Consultation Report on Liquidity Preparedness for Margin and Collateral Calls. In this response we would like to highlight several considerations that we believe are important to take into account on this topic. These considerations are strongly related to the liquidity management of NBFIs, but take a broader view than the preparedness of NBFIs alone.

PGGM Vermogensbeheer B.V. ("PGGM") is the pension administrator and asset manager for the Dutch pension scheme for the health care sector (*Stichting Pensioenfonds Zorg en Welzijn*, abbreviated *PFZW*). PGGM manages about EUR 240 billion in assets. We use derivatives to hedge risks, predominantly interest rate and currency risk, to protect the future retirement income of our beneficiaries. These hedges are, by nature, one-directional and can lead to substantial daily Variation Margin calls. Since 2010, PGGM has been actively involved in discussion with – amongst others – the EU, ECB, DNB, ESMA, EIOPA to address the liquidity risks that the move to central clearing, or more precisely: the move to cash collateral, imposes on pension funds.

In general, the recommendations made by the FSB make sense and are in line with a) good market practice and b) the way local supervisors already monitor liquidity risks. We strongly support the effort by the FSB to make all market participants prepared for any unforeseen liquidity events. We believe that adequate liquidity management by all market participants reduces the risks in the financial system and is beneficial to all participants and to the real economy as a whole.

As PGGM we have provided input for the responses of ISDA and of the Dutch Pension Federation (*Pensioenfederatie*). We fully support the answers given in both responses to the questions of the FSB. It would not be very efficient to repeat those answers in this response. For that reason, we will restrict ourselves to several key points that are strongly related, but strictly speaking do not directly answer the FSB's questions.

1. NBFIs do not operate in isolation

It is important to acknowledge the fact that NBFIs do not operate in isolation but are part of a wider financial ecosystem. Any policy or regulation that is aimed to improve the liquidity preparedness of NBFIs also needs take the behaviour of banks and other intermediaries into account. For example, it would not be very effective to encourage NBFIs to hold larger buffers of HQLAs, while at the same time banking regulation would make intermediation by the banks and transformation of the HQLAs into cash using repos very capital-intensive and expensive. We therefore recommend that policy makers and regulators take a holistic view and to make sure that regulations for all market participants are consistent and support efficient markets and connectiveness.

2. Liquidity buffers in cash raises issues for NBFIs

It is sensible and prudent to have sufficient amounts of liquidity available to withstand severe adverse market circumstances. Of course, the size of these liquidity buffers is the primary concern. They must be large enough to cope with extreme, but plausible stress scenarios. But apart from the size, the composition of these buffers is of equal importance. For most NBFIs it is not possible from a risk perspective to hold sufficient large amounts of cash in commercial bank accounts. These buffers are therefore invested in short term money market instruments like money market funds (MMFs), T-bills and (reverse) repos. When margin calls must be paid in cash, these investments have to be transformed back into cash again. PGGM believes this so called 'transformation risk' is one of the biggest risks for NBFIs. Even if the buffers are large enough, NBFIs will still be dependent on the money markets to function well, to be able to generate enough cash to meet margin calls. This dependency on the market and the willingness of banks to act as intermediaries is not something NBFIs can influence. Please bear in mind that under stressed circumstances this willingness tends to diminish quickly.

A partial solution to this problem would be to allow certain types of non-banks to maintain an account at a central bank. In this way it would be possible to hold buffers in cash and avoiding the necessity to go through the market to generate cash. In times of stress this could help to alleviate the selling pressure in the money markets and could thus be beneficial to the entire system. Of course, careful analysis has to take place to decide which (types of) non-banks would be eligible to maintain a central bank account.

An alternative solution to the suggestion above could be the use of non-cash collateral. Instead of selling or repo-ing securities, or redeeming MMF shares/participations, the transfer of very safe securities could be a highly effective measure. For example, the transfer of certificates of certain, highly regulated MMFs could be a feasible alternative to the transfer of cash. A further refinement could be to make granting of certain security rights over such securities an option in the place of, or additional to title transfer. It would deliver the same amount of certainty without the necessity to sell securities in the market.

3. The effectiveness of central bank instruments has decreased

After the GFC many new policies and regulations was aimed at making financial markets in general safer, and banks in particular. A side effect of these measures was that the liquidity risks was shifted to NBFIs such as pension funds, insurers and corporates. The push for cash-only collateral was the primary cause of this shift, but another side effect is that this shift makes the instruments of central banks less effective than before:

Central banks have several instruments at their disposal for assuring the smooth and orderly functioning of financial markets. Central banks use these instruments in case of extreme circumstances, when there is the risk that markets could come to a standstill and liquidity dries up. The Covid crisis in March 2020 is a good example. In such circumstances central banks provide ample liquidity to the market to support its functioning. Traditionally central banks provide this additional liquidity directly to banks, under the assumption that banks will pass it through to the rest of the market.

Recent events have shown that this underlying assumption does not longer hold. Firstly, referring back to the example of the Covid crisis, banks were not in need of additional liquidity, secondly and perhaps more importantly, banks were not willing to pass it through to the market. The effect was that the liquidity support by the central bank did not reach the parts of the market where it was most needed. The LDI crisis in the UK in September 2022 again made this highly visible. The Bank of England wanted to support the pension funds and LDI funds with liquidity but could only open a window that was available to banks alone. The BoE therefore could only ask banks to pass the liquidity support on, but there was no obligation for banks to do so. For the BoE this led to the conclusion that they needed a new instrument and an emergency window especially for pension funds and other eligible NBFIs[1].

Other central banks have come to similar conclusions.. The FED has created a (reverse) repo facility for Money Market Funds and following the events in March 2020, the Bank of Canada created a Contingent Term Repo Facility. The Bank of Canada facility is an emergency measure that can be activated and deactivated at the Bank's discretion. All

[1] See for example the speech by former BoE governor Andrew Hauser: A journey of 1000 miles begins with a single step: filling gaps in the central bank liquidity toolkit - speech by Andrew Hauser | Bank of England.

counterparties that can show significant activity in Canadian dollar money markets and/or fixed income markets are eligible to use this facility[2].

We would recommend all central banks around the globe, including the ECB, to carefully investigate this matter and to assess whether the instruments that are available to them are still effective enough to address stressed market circumstances. We believe it would be prudent not to wait for a new crisis to happen but instead create further measures under normal market circumstances if the investigations referred to earlier show a need for such measures.

Again, we would like to thank the FSB for this opportunity to share our opinion on the liquidity preparedness of NBFIs. We hope that the points raised in this response help the FSB to understand the liquidity risks that NBFIs face and that a single solution will not solve this issue. We are happy to answer any questions that might arise from our response or elaborate on specific points if desired.

Yours sincerely,

PGGM Vermogensbeheer B.V.

[2] For more details: Contingent Term Repo Facility - Bank of Canada