February 25, 2025

Dr. Klaas Knot
Chair
Dr. John Schindler
Secretary General
Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: Consultation Report: Leverage in Non-bank Financial Intermediation

Dear Drs. Knot and Schindler:

The Institute of International Finance (IIF) and its members appreciate the opportunity to comment on the proposed recommendations contained in the Financial Stability Board's (FSB) Consultation Report: *Leverage in Non-bank Financial Intermediation* (Consultation Report). The IIF supports the work of the FSB to monitor and address financial stability risks from leverage in non-bank financial intermediation (NBFI) through the monitoring of NBFI vulnerabilities, actions to address any material data gaps or challenges, and targeted and proportionate policy measures to address financial stability risks that could have serious adverse effects on the real economy.

Overarching Comments on the Consultation Report

The FSB Should Consider Publishing a Study of the Proposed Measures in the Consultation Report Prior to Advancing Policy Measures and Related Recommendations. We encourage the FSB to consider publishing for public consultation a comprehensive study of the policy measures in the Consultation Report prior to advancing specific policy measures to authorities. [1]

A study could inform FSB policy measures by reflecting how different jurisdictions have addressed NBFI vulnerabilities and risks through policy measures and the degree of success these measures have produced. It could also help to reflect the preliminary lessons learned from recent policy work and guidance by the Basel Committee on counterparty credit risk and by the FSB on liquidity preparedness for margin and collateral calls. A more iterative approach to NBFI guidance would help to align various workstreams in the overall FSB work program.

A study could allow the FSB to advance more practical and effective measures. It could also serve as an important tool for authorities, particularly in markets in which the NBFI ecosystem is relatively nascent

[1] We note as example of the type of study that could be conducted the FSB's recent study of securitization regulatory reforms that were introduced to address risks and vulnerabilities that contributed to weaknesses in certain securitization structures in the run up to the 2008 global financial crisis.

and/or rapidly evolving and expanding and could help to implement the FSB's recommendation that authorities consider the experiences of other jurisdictions in developing and refining their domestic frameworks.

Addre*ssing Data Challenges and Removing Obstacles to Information Sharing*. The emphasis on information sharing among authorities in order to address data challenges in the narrative following Recommendation 2 and in Recommendation 9 properly focuses on the importance of assessing and utilizing the wide array of data already available in the market (e.g. via trade repositories) before imposing additional reporting or disclosure requirements on users or providers of leverage. We welcome the FSB's call to authorities to remove obstacles to data sharing within their jurisdictions (e.g. by facilitating the sharing of information among financial and markets regulators) and to explore new avenues for information sharing across jurisdictional boundaries (e.g. via supervisory colleges).

Authorities have access to information that provides a broad view of the capital markets, however, institutional barriers may limit the degree of information sharing across authorities (e.g. information sharing between markets authorities and central banks). The FSB and its members should consider how these barriers could be reduced, such as through memoranda of understanding to facilitate reciprocal information sharing arrangements. Better information sharing arrangements would also reduce the burden on firms that are often subject to multiple, duplicative information requests from authorities, which may have different reporting thresholds and formats.

The extensive information available to authorities generally is not available to market participants. We ask the FSB to encourage authorities to consider ways in which aggregated and anonymized data and information could be shared more broadly with market participants in order to increase market transparency.

Cost/Benefit Analysis. We welcome the FSB's call for a consideration of both the costs and benefits (to both regulators and regulated entities) of enhanced monitoring of vulnerabilities and financial stability risks. Monitoring of vulnerabilities and risks without consideration of proportionality and materiality can result in the diversion of resources away from risk management and can impose unwarranted costs on firms and their regulators and supervisors.

The goal of the authorities should be to enhance risk management, recognizing that leverage is an integral part of a well-functioning financial market and that it is not practically feasible or desirable to completely eliminate risks associated with the use of leverage.

Targeted and Proportionate NBFI Policy Measures Should Be Applied to the Source of Vulnerabilities or Risks. We encourage the FSB to recommend that the authorities adopt targeted and proportionate NBFI policy measures to address the financial stability risks arising from NBFI leverage. Authorities should apply these measures to the NBFI sector or sub-sector(s) which give rise to the risks.

The important principles of proportionality and materiality could be better emphasized in Recommendation 4, as proposed below in our specific comments. Moreover, the adoption of any measures (Recommendation 5) should be intentional and carefully calibrated in light of the possible

unintended consequences to which they may give rise. It may be appropriate for authorities to phase in any such measures in order to avoid sudden changes in requirements that could disrupt markets and in order to test the efficacy of any such measures.

We would strongly caution against an approach to NBFI vulnerabilities that places additional constraints on financial institutions that are not the source of vulnerabilities or risks or to the providers of liquidity to NBFIs, including banking organizations. The requirements already applied to regulated financial institutions should be taken into consideration before imposing additional measures. Imposing additional restrictions on banking organizations, in particular, could negatively impact their intermediation capacity, with negative impacts on the liquidity preparedness of other market participants, including NBFIs.

The potential for additional measures to have serious negative implications for the availability and pricing of market liquidity should also be carefully assessed. Some measures may have a knock-on effect, potentially amplifying procyclicality and exacerbating existing stress situations. For example, minimum haircuts that increase in times of stress would increase funding costs and may give rise to procyclical deleveraging that would further reduce market liquidity. Broader mandates for central clearing could limit the ability of market participants to engage in bilateral transactions that allow for more flexible collateral arrangements that mitigate 'dash for cash' risks in times of stress. In addition, the potential for different measures to interact in a manner that has unintended negative consequences for the market should not be overlooked, and the role of market regulation in addressing potential vulnerabilities and risks should not be underestimated.

The Need for Flexible Measures That Recognize Jurisdictional Specificities While Recognizing the Risks of Regulatory Fragmentation. Final FSB recommendations should articulate that the specific recommendations, policy measures and metrics can and should be applied by authorities in a flexible manner that best suits their legal and regulatory frameworks. Further, the measures that may be most appropriate, effective and feasible may vary among different types of NBFIs.

As noted in the Consultation Report, authorities should take into consideration the experiences in other jurisdictions when reviewing their domestic frameworks. This is particularly important when there are important linkages or large volumes of activity across markets. The FSB should advise authorities to carefully balance the need to reflect jurisdictional specificities with the importance of reducing regulatory fragmentation, which has negative impacts on market efficiency and the interoperability of jurisdictional frameworks. Authorities should be alert to the possibility that measures adopted in host jurisdictions may interact with home country measures in unexpected ways with unintended negative consequences for the affected markets.

The Need to Distinguish Between Regulated and Non-regulated NBFIs, Taking into Account the Degree to which Certain NBFIs Commonly Engage in Highly Leveraged Strategies. We encourage the FSB to differentiate among non-bank market participants that are already highly regulated and subject to comprehensive supervision (e.g. asset managers and insurers) and those market participants that are not subject to comprehensive regulatory and supervisory frameworks (or in some cases, *any* regulatory or supervisory framework). Regulated market participants are subject to robust monitoring and supervision,

and many must comply with prudential leverage limits.[2] Accordingly, the FSB should focus its primary attention on market participants that are not subject to comprehensive regulation and supervision (or any regulation or supervision), as a lack of regulatory or supervisory oversight may increase risks in the markets.

In addition to distinguishing between regulated and non-regulated NBFIs, the FSB should advise authorities to focus any potential policy measures on non-regulated NBFIs that commonly engage in highly leveraged strategies, especially where there is a lack of information regarding the degree of leverage inherent in those strategies (e.g. a highly leveraged derivatives position).

Specific Comments on the Consultation Report

Recommendation 1 provides that authorities should have a domestic framework to monitor NBFI leverage vulnerabilities and to assess data challenges. We agree broadly with this recommendation, but we encourage a flexible and proportionate approach to the development of domestic frameworks that reflects different legal and regulatory frameworks as well as the importance of the NBFI sector and/or specific subsectors to local markets and the real economy in a particular jurisdiction. We ask the FSB to add additional language (in italics) to Recommendation 1 to reflect the need for flexibility, proportionality and materiality, as follows:

Recommendation 1: Authorities should have a domestic framework to identify and monitor *material* vulnerabilities related to NBFI leverage and associated financial stability risks in an effective, frequent and timely manner. The domestic framework should be proportionate to the financial stability risks that such vulnerabilities may pose, particularly in core financial markets. *The domestic framework should reflect the legal and regulatory frameworks in effect in the jurisdiction, as well as the importance of the NBFI sector and specific subsectors to the local market and to the real economy.* Authorities should regularly review their domestic framework and enhance it as appropriate, including the risk metrics utilized, and take steps *to collaborate with other authorities* to improve consistency in the definition and calculation of those metrics.

Recommendation 2 relates to data challenges and outlines steps that authorities can take to assess and reduce those challenges. We appreciate the reference to considering the experiences in other jurisdictions when authorities review their domestic frameworks, as this can enhance information sharing and potentially reduce regulatory fragmentation. A lack of data and information sharing among regulators and/or central banks frequently requires market participants to report the same information to multiple regulators under different reporting conventions and formats, creating inefficiencies for reporting companies and regulators alike.

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[2] For example, in the EU, asset managers regulated through the UCITS and AIFM Directives are required to report their positions to the securities regulators and Eurozone central banks. EU asset managers regulated under the UCITS Directive are subject to a 100 percent leverage limit, while those regulated under the AIFM Directive are subject to enhanced reporting requirements when fund leverage exceeds 300 percent. ESMA regularly monitors and assesses the leverage of EU alternative investment fund managers and discloses leverage statistics in periodic risk reports.

The final sentence of the penultimate paragraph in the narrative under Recommendation 2 should recognize that some of the information that authorities collect from market participants should be disseminated to the public in an aggregate and anonymized form, subject to an appropriate cost-benefit analysis that addresses the considerations highlighted in the response to Recommendation 3 below.

We believe that a materiality standard should be added to the final sentence of Recommendation 2, as follows:

Authorities should seek to address data challenges and, where appropriate, collaborate through the FSB and SSBs to reduce those challenges that may hinder the effective cross-border monitoring of *material* vulnerabilities, as set out in Recommendation 9.

Recommendation 3 advises authorities to review the granularity, frequency and timeliness of disclosures and determine if additional disclosures are warranted. Requirements for disclosures to the public should be carefully and narrowly crafted in a risk-based manner and with a view to avoiding any release of information that could create or exacerbate market instability or stress (e.g. publicly disclosing detailed large trader positions may unintentionally affect pricing and/or spreads due to potential signaling effects). The public release of some information may be harmful to client interests or even breach fiduciary duties owed to clients. Overbroad public disclosure could result in the release of proprietary trading, hedging or investment strategies that could prompt unscrupulous market participants to front-run or reverse engineer the positions of reporting entities, particularly in concentrated or relatively illiquid markets. This may be the case even when disclosures are aggregated and/or anonymized, for example, in concentrated or less liquid markets. In light of these concerns, the FSB should advise authorities to consider carefully whether information should be disclosed publicly or provided through confidential supervisory reporting channels.

We believe that the principles set forth in the Consultation Report are appropriate for the development of a minimum set of disclosures. Ideally, the minimum set of disclosures would rely on *aligned* data and metrics and/or a common lexicon, recognizing that full harmonization of data and metrics is unlikely to be feasible given differences across markets and legal/regulatory frameworks.

The FSB should recommend the inclusion of industry working groups in the development of any minimum set of disclosures in order to develop a set of disclosures that is most relevant and decision-useful to leverage providers.

The FSB should also reflect the important role of private disclosure in cases where broad-based public disclosure is inappropriate and may pose risks to counterparties and market integrity. Private, counterparty-to-counterparty disclosure may be bespoke and specifically tailored to the risks and market activities of a counterparty.

Recommendation 5 advances activity-based, entity-based and concentration-based measures for authorities to consider in order to address financial stability risks from NBFI leverage in core financial markets. While activity-based measures can reflect the important principles of level playing field and same risk, same regulatory treatment, in order to address the buildup of risks in a cohort of the NBFI sector, it

may be more appropriate and expeditious to apply and monitor the impact of entity-based measures, such as leverage limits. However, the need for any such measures should be well articulated, the implications of such measures for investment and liquidity should be thoroughly analyzed, and the calibration of the measures should be precisely targeted to achieve important and specific NBFI financial stability policy goals. We do not believe that the FSB is suggesting the imposition of entity-based bank-like requirements on NBFIs in the Consultation Report, but we caution against any extension of bank requirements to the NBFI sector. The imposition of bank-like requirements on NBFIs would not reflect the different risk profiles of banking organizations and NBFI and, thus, would not be proportional, tailored and targeted to the risks and vulnerabilities posed by NBFIs.

Recommendation 5 asks authorities to consider a wide range of policy measures. One such measure is minimum haircuts on non-centrally cleared securities financing transactions (SFTs), in addition to haircuts dynamically set by market participants. This recommendation reflects the FSB's SFT framework, *Regulatory Framework for Haircuts on Non-Centrally Cleared Securities Financing Transactions*[3], which would introduce minimum haircuts for non-centrally cleared SFTs in which financing against collateral other than government securities is provided to non-banks. Under the FSB SFT framework, authorities could implement the floor through capital requirements or minimum margin requirements.

We believe that the implementation of SFT minimum haircuts under the FSB framework would limit banks' ability to enter into SFTs with non-banks and, thus, negatively impact the ability of a wide range of firms to secure funding for their business activities at an economical cost. A well-functioning SFT market (importantly, the repo market) supports market liquidity and contributes to the efficient allocation of capital. The imposition of minimum haircuts for certain non-centrally cleared SFTs could reduce the overall liquidity of the SFT market if the volume of transactions were to decrease. Reduced SFT market activity could have systemic consequences for financial markets.

The proposed differentiated FSB approach to SFT minimum haircuts for banks and broker-dealers could also give rise to regulatory arbitrage that would not promote a level playing field among providers of non-bank financing.

We respectfully note that the FSB's SFT framework and its implementation through bank capital rules have been subject to lengthy implementation delays. In our view, the SFT framework needs further review and revision and further quantitative impact analysis prior to implementation. We encourage the FSB to consider policy measures related to SFTs in light of the larger work program on SFTs and to defer consideration of SFT-related measures pending the completion of a specific review of the treatment of SFTs.

Another measure suggested for consideration by authorities is concentration-related add-ons. While concentration add-ons are an important part of an individual firm's counterparty credit risk management framework, it is not clear how they would be calibrated, used or assessed for effectiveness at a system-wide level by regulators. We encourage the FSB to remove concentration-related add-ons from the list of possible measures.

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[3] https://www.fsb.org/uploads/P070920-1.pd

The Consultation Report also raises the use of central clearing mandates in SFT and derivatives markets as an activity-based measure. Any requirement to centrally clear repo transactions should be carefully considered in terms of the impacts it could have for end-users, clearing firms and central counterparties (CCPs). For example, while central clearing can bring benefits related to risk management and multilateral netting, it can also create new systemic risk concentrations at CCPs, and create new constraints (e.g. liquidity, risk-weighted capital, single counterparty credit limits) for clearing members and end-users.

The U.S. authorities have mandated central clearing for U.S. Treasury repo transactions, which is currently being implemented. We recommend that the FSB observe the implementation process in the U.S. and benefit from the lessons learned from that process before making any recommendations for further SFT clearing mandates.

Relatedly, clearing mandates are already widely used in the derivatives markets, following the G20 reforms implemented following the 2008 global financial crisis. There are existing processes at jurisdictional level to identify the products that are sufficiently liquid and standardized to support a central clearing mandate. Expanding beyond this set of appropriate products would subject the markets to undue risk.

We would recommend the deletion of the lists of activity-based and entity-based measures from Recommendation 5, as they may be perceived by some authorities as a prescriptive set of measures that should be enshrined in legislation or regulation regardless of their suitability in a particular jurisdiction. The discussion of specific measures in the narrative for Recommendation 5 should emphasize that the measures are illustrative, not intended to be prescriptive, and may not be suitable for a particular jurisdiction depending on its market structure or legal or regulatory framework.

The FSB should advise authorities to be thoughtful and proportionate in the application of any measures and to review carefully the effectiveness of those measures over time. Authorities should be advised to be aware of the unintended consequences and impacts of some measures, including negative impacts on market liquidity. Measures should be narrowly crafted, targeted precisely at the source of vulnerability, and carefully calibrated in order to avoid negative unintended consequences.

Recommendation 6 on counterparty credit risk and Question 14 in the Consultation Report appear to suggest a reopening of the Basel Committee counterparty credit risk management guidelines that were finalized in December 2024.[4] These guidelines are now in the process of being implemented in member jurisdictions. These guidelines were the subject of extensive review and discussion by Basel Committee members and industry review and comment, including by the IIF jointly with ISDA[5]. We encourage the FSB to clarify that it is not suggesting any changes to these guidelines until sufficient time has been given to authorities to implement the new guidelines and assess their effectiveness. Moreover, liquidity providers distinguish between different types of NBFIs based on their risk profiles, their degree of

[4] https://www.bis.org/bcbs/publ/d588.pdf

[5] https://www.iif.com/portals/0/Files/content/Regulatory/32370132_bcbs_ccr_guidelines_consultation_response_-_final_without_signatures.pdf

prudential regulation and oversight, and their use of highly leveraged strategies when conducting due diligence and counterparty risk assessments.

Recommendation 7 advises authorities to review the adequacy of existing private disclosure practices between leveraged non-bank financial entities and leverage providers. We welcome the FSB's call for authorities to agree to a minimum set of disclosures provided by leverage users to leverage providers, as it would set an industry standard that would facilitate the receipt of robust and consistent data. Liquidity providers often face challenges in obtaining information from counterparties for a variety of reasons, including legal and/or regulatory constraints and the reluctance of counterparties or third-party service providers to provide detailed information or information that is not always required by other liquidity providers. The FSB should reflect in the narrative around Recommendation 7 that authorities should consider the existing reporting requirements (including to central banks and markets authorities) as well as the prudential requirements imposed on leverage providers before adding additional requirements.

We appreciate the opportunity to comment on the Consultation Report and we would welcome further dialogue and discussion of these issues with the FSB members and Secretariat. Please contact Mary Frances Monroe (mmonroe@iif.com) or Gaku Kobayashi (gkobayashi@iif.com) with any comments or questions regarding this submission.

Respectfully submitted,

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