10 December 2024

Liquidity Preparedness for Margin and Collateral Calls

Overview of responses to the consultation

1. Introduction

On 17 April 2024, the FSB published a consultation report aimed at enhancing liquidity preparedness for margin and collateral calls among non-bank market participants. The consultation proposed eight policy recommendations in the areas of liquidity risk management, governance, stress testing, and collateral management practices. The objective was to strengthen the resilience of the financial system by improving the liquidity preparedness of non-bank financial entities. This note presents a summary of the responses received and changes made in response to those comments.

The FSB received 25 responses to the consultation, which ended on 18 June 2024. Respondents included a broad range of market participants including trade associations (11), which represent a diverse range of sectors including global financial institutions, asset management, insurance, securities exchanges, derivatives markets, money market funds, hedge funds, alternative investments, and energy commodity trading. In addition, responses were received from regulated financial institutions (10), commodities firms (1), and others (3).

Overall, respondents supported the FSB's focus on enhancing liquidity preparedness and the risk-based, proportionate approach proposed in the report. Having considered the feedback and suggestions received, some amendments and clarifications were made to the final report. A detailed summary of the feedback is provided in section 2. The following summarises the key FSB responses and changes:

- **Liquidity risk management practices of counterparties:** Several respondents raised concerns about the limitations on the information market participants can obtain regarding other participants' activities and positions, particularly concerning counterparties' risk management practices. Given the challenges in obtaining proprietary and sensitive information about counterparties, it was suggested that this should be done on a best-efforts basis. The text has been adjusted to allow more flexibility in meeting the intended outcomes of the recommendations and has been amended to note, for example, that 'to the maximum extent possible, market participants should take into consideration how their counterparties may respond during times of market stress'. The phrase "to the maximum extent possible" was added in several places throughout the report, as appropriate.

- **Stress testing:** There was general agreement on the importance of performing stress testing at the fund level rather than the aggregate level. Respondents argued that this approach better reflects the unique business models and liquidity profiles of individual funds. They emphasised that stress tests should be tailored to the specific nature and existing regulations of entities. Some changes were made in the explanatory text of Recommendation 4 with respect to stress tests to recognise that they should be conducted at the individual entity (e.g. fund) level to reflect unique liquidity profiles, and if appropriate, additional stress tests should also be conducted at an aggregate level.

- **Role of Central Counterparties (CCPs) in improving the predictability of margin calls:** Respondents emphasised the key role that CCPs play in improving participants' liquidity preparedness. They noted that better transparency and predictability from CCPs regarding margin models and practices are crucial for market participants to effectively manage liquidity risks. Respondents also called for greater transparency from CCPs and clearing members to support effective stress testing and scenario design. Whilst this highlights the importance of CCPs in the broader context of liquidity preparedness, it falls outside the scope of the current consultation paper. This topic is being addressed by the ongoing complementary work of the BCBS, CPMI and IOSCO in their consultation report on central counterparty transparency and responsiveness of initial margin (IM) models and clearing member transparency to clients and CCPs; this is set out in Section 1 of the report.[1]

- **Resilience of repo markets:** Several respondents expressed concerns about the reliability of repo markets during stressed conditions and advocated for central banks to act as liquidity providers. Footnote 16 was added to highlight that the FSB is undertaking further work on the functioning and resilience of repo markets.

- **Scope:** The majority of respondents expressed support for the scope of the recommendations proposed by the FSB. However, some questioned the exclusion of commercial banks and financial infrastructures. They remain excluded from the scope, as per the mandate from the 2022 BCBS-CPMI-IOSCO report. The role of CCPs and commercial banks is covered in complementary reports by BCBS, CPMI, and IOSCO, ensuring a comprehensive approach without duplicating efforts. These include reports on streamlining variation margin (VM) processes, and transparency and responsiveness of IM models in both centrally and non-centrally cleared markets.[2, 3, 4] Additionally, a paragraph in Section 2.1 indicates that financial institutions such as clearing members and intermediaries that clear derivatives and securities financing transactions with non-bank financial entities should also consider the FSB recommendations. A sentence has been added to clarify that the recommendations should be considered in conjunction with the SSBs' work set out in Section 1.

- **Proportionality and materiality:** Respondents generally support the approach to proportionality and materiality, with some calling for differentiation between regulated and non-regulated NBFIs. Some respondents also provided feedback on the need to

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[1] See BCBS-CPMI-IOSCO (2024), *Transparency and responsiveness of initial margin in centrally cleared markets – Review and policy proposals*, January.

[2] Ibid.

[3] BCBS-IOSCO (2024), *Report on streamlining VM processes and IM responsiveness of margin models in non-centrally cleared markets*, January.

[4] See CPMI-IOSCO (2024), *Streamlining variation margin in centrally cleared markets – examples of effective practices*, February.

consider the diversity of business models and existing requirements. The report sets out in Section 2.4 that the high-level recommendations should be applied proportionately to reflect the underlying risks of different types of non-bank market participants. This already addresses industry feedback on the need to consider the diversity of business models and existing requirements. The report emphasises a proportionate approach focusing on material exposures to margin and collateral calls. The need to differentiate between regulated and non-regulated NBFIs is already acknowledged through the recommendations being applied proportionately based on risk materiality and scope. One change has been made to reiterate in Section 3 the focus on material exposures to spikes in margin and collateral calls during times of market stress. Footnote 32 was added in section 3.1 to reiterate the proportionate approach focusing on material exposures to margin and collateral calls.

- **Liquidity risk governance:** Respondents agreed that the involvement of multiple stakeholders in the decision-making process should not impair market participants' ability to meet margin and collateral calls. Further amendments were made to clarify this.

- **Existing liquidity risk frameworks:** Respondents highlighted the importance of leveraging existing regulatory frameworks, such as AIFM and UCITS Directives, and emphasised the need for enhancing front-to-back liquidity risk management awareness. These specific suggestions have been incorporated in footnote 33.

- **General feedback on collateral management challenges:** Many challenges raised by respondents are outside the scope of the report, such as collateral eligibility to meet margin calls. Issues with cash buffers and the cost of enhancing collateral management are addressed by the changes to Recommendation 7, which was updated to note that sufficiently available cash or reliable liquidity lines could be maintained to meet cash-only margin calls in line with the market participants' liquidity risk tolerance in normal and stressed market conditions. Footnote 39 was added noting that the recommendation should be read jointly with the BCBS-IOSCO consultation report on streamlining VM processes and the responsiveness of IM models in non-centrally cleared markets. It encourages firms to consider providing flexibility in bilaterally acceptable collateral during periods of stress for VMs, within the set of permissible collateral types per the BCBS-IOSCO margin requirements for non-centrally cleared derivatives and national regulations, and to do so with appropriate haircuts.

- **Non-financial market participants:** No changes were made in response to feedback requesting that the recommendations should not apply to non-financial market participants. The recommendations apply to all non-bank market participants with material derivatives and securities exposures, including non-financial market participants. Although non-financial market participants are not subject to the full range of regulations and supervisory oversight applicable to non-bank financial market participants, they would benefit from the FSB recommendations as sound practices. This inclusion aims to enhance overall financial stability by promoting best practices across a broader range of market participants, including financial institutions clearing derivatives and securities financing transactions as counterparties.

- **Annexes 1 and 2:** Annexes 1 and 2 have been updated to include more granular information regarding European Regulation, addressing requests for more detailed explanations on the rules for European investment funds.

2. Summary of feedback received

2.1. Causes of inadequate liquidity preparedness (Q1)

Overall, there was broad consensus that the report effectively covers the different causes of inadequate liquidity preparedness. Respondents noted that the proposed recommendations address the key elements necessary for participants to mitigate liquidity risk arising from margin and collateral calls.

Some respondents highlighted the need to consider the diversity of business models and specificities among NBFI entities, existing sector-specific requirements, and the causes of inadequate liquidity preparedness identified in the four stress episodes studied by the FSB. Additionally, several respondents emphasised the role of CCPs in improving the predictability of margin calls to enhance participants' liquidity preparedness.

2.2. Scope and general approach (Q2 – Q4)

Comments received on scope (Q2)

The majority of respondents expressed support for the scope of the recommendations proposed by the FSB. However, two aspects were questioned. Some respondents argued that the exclusion of commercial banks from the scope was a concern as it prevents a holistic view of market interactions and suggested that the recommendations should apply to all market participants, including banks. One respondent also highlighted the role of direct asset holders, who may behave in a correlated manner during stress but are not subject to the same level of regulation as NBFIs. Several respondents urged the FSB to clarify that the recommendations do not apply to non-financial market participants. Conversely, others argued that the recommendations should apply to all market participants, including non-regulated entities, to avoid creating incentives to shift activities into structures outside the scope of the recommendations.

One respondent requested more detailed explanations regarding the rules for European investment funds outlined in Annexes 1-2 of the consultation report. Several respondents also emphasised the diversity of sector-specific requirements within the NBFI sector and the need for these to be considered when applying the recommendations.

Comments received on focus (Q3)

The majority of respondents broadly agree with the focus of the FSB’s policy recommendations on liquidity risk management, governance, stress testing, and collateral management practices. Key points frequently raised include the need for tailored recommendations based on the specific nature and existing regulations of entities. Several respondents expressed concerns about the reliability of repo markets during stressed conditions and advocated for central banks to act as liquidity providers. Transparency in margin models and collateral practices was another recurring theme, with multiple respondents calling for greater clarity to help market participants prepare for stress events. Additionally, there were proposals to expand the range of eligible collateral, including the use of money market funds (MMFs), to mitigate procyclical effects. Concerns about overly prescriptive regulations and the need for flexibility in stress testing were also noted by some respondents.

Comments received on approach (Q4)

Respondents generally support the approach to proportionality and materiality, with frequent calls for clear differentiation between regulated and non-regulated NBFIs. Some respondents raised concerns about the practical implementation of proportionality and materiality, finding the recommendations lacking in practical detail. They highlighted that recommendations should be applied at the fund level rather than the management company level due to the distinct investment strategies and risk policies of individual funds. The need to consider the cost of liquidity measures was also emphasised by several respondents. Additionally, there were warnings against the potential for regulatory inconsistency and arbitrage if assessments are made by different regulators across jurisdictions. Some respondents stressed the importance of not basing regulatory standards solely on the size of market participants, advocating instead for a focus on the nature and risks of their activities.

2.3. Liquidity Risk Management and Governance (Q5)

Several market participants suggested that the recommendations should allow more flexibility to meet the intended outcomes and acknowledge that guarantees are not always possible. Some respondents disagreed with differentiating proposals based on the "size of the market participant" or their "footprint/role in the financial system," and requested that materiality and proportionality be emphasised in the recommendations.

Concerns were expressed about the limitations on the information market participants can obtain regarding other participants' activities and positions, particularly concerning counterparties’ risk management practices, due to proprietary and sensitive information. Additionally, respondents highlighted the need for improved transparency from CCPs and less restrictive collateral eligibility. They also pointed out the role of authorities in improving access to data by supervisors and increasing visibility into other parts of the financial system.

Respondents emphasised the importance of applying the recommendations at the investment "fund" level rather than the "business line" level, as liquidity risk is specific to each fund. Other specific suggestions included linking to existing AIFM and UCITS Directives, enhancing front-to-back liquidity risk management awareness, involving multiple stakeholders in decision-making, establishing contingency plans for unwinding leveraged positions, and aligning language with the final FSB consultation on vulnerabilities in open-ended funds.

2.4. Stress testing, scenario design and jurisdictional/sector-specific differences (Q6 and Q7)

Comments received on stress testing and scenario design (Q6)

There was general agreement with the proposal. Key suggestions included performing stress testing at the fund level rather than the aggregate level, as this better reflects the unique business models and liquidity profiles of individual funds. Greater transparency from CCPs and clearing members (CMs) was frequently requested. The difficulty of considering counterparties' actions was noted, with recommendations that this be done on a best-efforts basis due to the complexity and low likelihood of producing meaningful results. Clarification was requested regarding the use of manager size as an indicator of liquidity risk, with the consultation paper primarily referring to size in the context of proportionality and materiality.

Comments received on jurisdictional and sector-specific differences (Q7)

Several key points were raised concerning jurisdictional and sector-specific differences. Data limitations were frequently mentioned as an issue. Concerns were expressed that stress testing at the jurisdictional level could result in an unlevel playing field. Three respondents suggested a public solution in the form of greater access to central bank liquidity; however, this matter falls outside the scope of the FSB's work. It was suggested that the focus should be on identifying entities not subject to appropriate regulation rather than imposing more requirements on those already regulated. The report would benefit from a more comprehensive understanding of existing rules that already apply.

2.5. Collateral management practices (Q8 and Q9)

Comments received on collateral readiness recommendations (Q8)

Most respondents were generally supportive of the recommendations and the goals underlying them. The FSB recommendations address, according to the respondents, the key elements regarding collateral readiness for margin calls. However, several concerns were raised about Recommendation 7, which requires market participants to maintain sufficient available cash to meet cash-only margin calls with a high degree of certainty in the called currency, time zone, and location of delivery. Some respondents suggested expanding the range of eligible assets to meet margin calls to avoid over-reliance on cash, which can lead to procyclical stress during "dash for cash" episodes and disrupt the economic performance of market participants. Others highlighted that national regulations and sector-specific considerations may constrain the level of cash that a market participant can hold.

One respondent emphasised the necessity of considering the varying internal operational capabilities of each market participant, suggesting that each should conduct their own due diligence to ensure an appropriate collateral framework. The interconnected nature of the derivative post-trade ecosystem should also be considered when assessing collateral management practices. Another respondent highlighted that operational readiness for monitoring and preparing for spikes in margin calls is closely related to well-established risk management system processes and technology. Concerns were also raised about the ability of market participants to predict margin and collateral calls with high certainty, especially regarding CCPs' discretion to use ad hoc margin calls.

Comments received on collateral management challenges (Q9)

Challenges related to collateral management practices were raised with many focused on CCPs and clearing members, which are largely out of scope for these recommendations but are being addressed in other related reports. Several respondents pointed to challenges due to requirements that margin be paid in cash and called for expanding collateral eligibility. Most comments did not clearly distinguish between variation margin and initial margin or between centrally cleared and bilateral positions. A few respondents noted the challenge of holding cash buffers, citing trade-offs between maintaining liquidity buffers in cash and the associated cost in loss of return. Some noted that regulations limit the ability of certain NBFIs to hold large amounts of cash, leading firms to maintain plans for selling assets as part of their liquidity management.

Another challenge raised was the lack of transparency around margin calls, particularly by CCPs. While this topic is covered by other work and is out of scope for this report, several respondents argued that transparency is fundamental to the effectiveness of the recommendations for client collateral management. One response noted issues with the quality, granularity, and accessibility of data available to clients, suggesting that data limitations would make many recommendations challenging to implement. It was also suggested that the data challenge could vary by jurisdiction, while another response suggested that clients need to more actively use available data.

The standardisation and automation of collateral management processes were raised several times, with some responses indicating a need for it, while others suggested that standards and processes are well-established, possibly varying among different industries. A few responses noted that the cost of enhancing collateral management might be prohibitive for smaller firms, with one response suggesting that full contingency plans should be established by authorities. Finally, one response called for a significant phase-in period. Broader issues like the definition of NBFIs, the scope of the report, and the validity of limitations based on materiality were also raised.