INVESTMENT COMPANY INSTITUTE

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FSB Publishes Consultation on NBFI Leverage

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TO: ICI Members
ICI Global Members
Asia Regulatory and Policy Committee
Derivatives Markets Advisory Committee
Europe Regulatory and Policy Committee
Financial Stability and OEF Working Group SUBJECTS: Derivatives
Financial Stability
International/Global
Trading and Markets RE: FSB Publishes Consultation on NBFI Leverage

On 18 December 2024, the Financial Stability Board (FSB) published a consultation on leverage in non-bank financial intermediation (NBFI).[1] Responses to the Consultation's questions are requested by electronic form by 28 February 2025 and ICI plans to submit a response.

Overview

The Consultation sets forth nine policy recommendations that are addressed to authorities with the objective of enhancing authorities' and market participants' ability to monitor vulnerabilities associated with NBFI leverage. With enhanced monitoring and increased information sharing, authorities can better identify risks to financial stability and take actions to mitigate the impacts of such risks. The FSB has identified insufficiently consistent global standards for reporting leverage as a significant hinderance to authorities' ability to comprehensively assess and monitor NBFI leverage and associated financial stability risks on a global basis.

Generally, the policy recommendations address NBFI participants' use of leverage, including financial[2] and synthetic.[3] NBFI participants within the scope of the policy recommendations include hedge funds, other leveraged investment funds, pension funds, and insurance companies. In addition, banks and broker-dealers are covered in their role as leverage providers.

The Consultation is part of the FSB's ongoing NBFI Work Programme, which seeks to enhance the resilience of NBFI and reducing the need for extraordinary central bank interventions. The proposed policy recommendation follow from the FSB's 2023 report on the financial stability implications of NBFI leverage, which found that leverage played a significant role in recent stress episodes.[4]

Summary of the proposed policy recommendations

The proposed policy recommendations cover risk identification and monitoring (Recommendations 1-3), leverage in core financial markets (Recommendations 4-5), counterparty credit risk management (Recommendations 6-7), the same risk, same regulatory treatment principle (Recommendation 8), and cross-border cooperation (Recommendation 9).

Risk identification and monitoring (Recommendations 1-3)

The Consultation recommends that authorities have a domestic framework in place to identify and monitor financial stability risks that arise from NBFI leverage. These frameworks should consider sector or system-wide risks that may arise from combined positions of entities with similar business models or investment strategies and be supported by toolkit metrics - which are metrics aimed at monitoring NBFI vulnerabilities, and include:

- leverage metrics, such as gross, net, and adjusted measures of leverage;
- collateralisation, margins and liquidity risks related to leverage;
- sensitivity to market risk, assessing the impact of changes in underlying risk factors and standardised stress test results; and
- concentration risk measured at both entity-level and market-level, as well as crowdedness.

Recommendation 2 addresses data challenges, which should be reflected in domestic frameworks. The FSB proposes that domestic frameworks should be reviewed as to enhance the usability of data, their quality and access, as well as potential data gaps within existing reporting requirements. Before considering further reporting demands, authorities should address the existing redundancies and simplify reporting procedures.

The Consultation proposes that authorities should review the degree of existing public disclosures on market dynamics (e.g., aggregate positioning, or transaction volumes), as to increase transparency regarding concentration risks and exposures. Enhanced disclosures should be available to the public, either by the authority or the relevant financial market infrastructure or by the entity itself, with a focus on concentration risk and crowdedness.

Leverage in core financial markets (Recommendations 4-5)

The Consultation proposes that authorities use several types of policy measures to monitor and identify risks associated with leverage.

Activity-based measures can be used to target highly leveraged strategies which may be subject to different regulatory frameworks or be outside of the regulatory perimeter. Such measures may include minimum haircuts in SFTs, including government bond repos; enhanced margin requirements between NBFI entities and their derivatives counterparties; and central clearing mandates in SFT and derivatives markets.

Entity-based measures can be used to constrain the amount of leverage and enhance the resilience of large firms or cohorts of firms and can include direct limits on leverage and indirect leverage constraints linked to NBFI participants' risk exposures.

Concentration-related measures can be applied at the entity or activity level with an aim of addressing the risk that concentration will amplify risks in certain markets or products. Such tools may include concentration add-ons for margins and haircuts in SFT and derivatives markets; concentration and large exposure limits; and large position reporting requirements.

Authorities may also consider issuing supervisory guidance.

Where authorities do not have adequate tools to address system-wide risks under existing frameworks, the Consultation proposes that they consider new and additional policy measures, which could include adjusting or widening the scope of existing frameworks and giving authorities new or enhanced powers. The FSB also warns that authorities should consider potential unintended consequences of specific measures and calibrate policy measures to minimise negative effects such as reducing market liquidity, increasing transaction costs, and incentivising undesirable risk-shifting behaviours. In this regard, authorities should cooperate to minimise the potential for cross-border arbitrage, where possible.

Counterparty credit risk management (Recommendations 6-7)

The Consultation proposes that authorities timely and thoroughly implement the relevant guidelines from the Basel Committee on Banking Supervision (BCBS). The FSB also recommends that authorities review the adequacy of existing private disclosure practices between NBFI entities and leverage providers and consider developing mechanisms or minimum standards to enhance their effectiveness

Same risk, same regulatory treatment (Recommendation 8)

The Consultation proposes the general principle of same risk, same regulatory treatment to address incongruencies in the regulatory treatment of NBFI leverage. Congruent is not meant to imply identical treatment. Rather, regulatory treatment should be designed to reflect the specific characteristics of different entities and the risks they can pose to the broader financial system.

Cross-border cooperation (Recommendation 9)

The Consultation seeks to enhance information sharing across jurisdictions to improve cross-border risk monitoring. The FSB encourages authorities to put in place information sharing agreements and establish regular communication channels with key peers for sharing high-level aggregate data on leverage.

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Notes

[1] FSB, Leverage in Non-bank Financial Intermediation: Consultation report (18 December 2024).

[2] Financial leverage is defined as "borrowing via loans, bonds, repurchase agreements (repo), and other securities financing transactions (SFTs)." Consultation at 4.

[3] Synthetic leverage is defined as "using derivatives that create exposures whose value depends on the value of the underlying asset." Consultation at 4.

[4] FSB, The Financial Stability Implications of Leverage in Non-Bank Financial Intermediation (6 September 2023).
