FSB - Liquidity Preparedness for Margin and Collateral Calls
18 June 2024

Background

Established in 1961, the World Federation of Exchanges (WFE) is the global industry association for exchanges and clearing houses (CCPs). Headquartered in London, it represents over 250 market infrastructure providers, including standalone CCPs that are not part of exchange groups. Of our members, 36% are in Asia-Pacific, 43% in EMEA, and 21% in the Americas.

WFE's 87 member CCPs and clearing services collectively ensure that risk takers post some $1.3 trillion (equivalent) of resources to back their positions, in the form of initial margin and default fund requirements. The exchanges covered by WFE data are home to over 55,000 listed companies, and the market capitalisation of these entities is over $111 trillion; around $124 trillion (EOB) in trading annually passes through WFE members (at end 2023).

The WFE is the definitive source for exchange-traded statistics, and publishes over 350 market data indicators. Its free statistics database stretches back more than 40 years and provides information and insight into developments on global exchanges. The WFE works with standard-setters, policy makers, regulators, and government organisations around the world to support and promote the development of fair, transparent, stable and efficient markets. The WFE shares regulatory authorities' goals of ensuring the safety and soundness of the global financial system.

With extensive experience of developing and enforcing high standards of conduct, the WFE and its members support an orderly, secure, fair, and transparent environment for investors; for companies that raise capital; and for all who deal with financial risk. We seek outcomes that maximise the common good, consumer confidence, and economic growth, and we engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in a globally integrated financial system.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

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Introduction

The WFE appreciates the opportunity to comment on the Financial Stability Board's (FSB) consultative report *Liquidity Preparedness for Margin and Collateral Calls* (the Report), and to share perspectives and feedback on behalf of our members. The Report forms part of the "Phase 2" book of work stemming from the 2022 *Review of Margining Practices*, which the WFE has actively engaged with, particularly on matters relating to the Transparency and Responsiveness of Initial Margin and the Streamlining of Variation Margin in centrally cleared markets.

We therefore remain supportive of the broader effort to ensure that the international policy framework promotes liquidity preparedness of market participants, the non-bank financial intermediation (NBFI) sector's liquidity preparedness, and intermediaries' provision of liquidity to clients. This preparedness is a key factor for both centrally cleared markets and the health of the derivatives industry overall, which the WFE wishes to emphasise as crucially important for hedging.

Specific Questions

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?**

   Yes, the approach identifies the key causes of inadequate liquidity preparedness for non-bank market participants during times of stress.

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

   Yes, the scope of the proposed policy recommendations is generally appropriate. The WFE supports the FSB's eight recommendations for participants to:

   - Include liquidity risk arising from margin and collateral calls in liquidity risk management and governance frameworks,
   - Set liquidity risk appetites for margin and collateral calls as well as contingency funding plans to ensure liquidity needs can be met,
   - Have regular reviews of liquidity risk frameworks to ensure on-going effectiveness in mitigating liquidity risk exposures to spikes in margin and collateral calls, including during times of stress.

   As well as to conduct:

   - Liquidity stress tests with respect to margin and collateral calls to identify the sources of liquidity strains and ensure the calibration of adequate, diverse and reliable sources of liquidity and collateral, consistent with the market participants' risk appetite,
   - Liquidity stress tests to cover a range of extreme but plausible scenarios.

   And to establish:

   - Resilient and effective operational processes and collateral management practices,
   - Sufficient levels of cash and readily available and diverse liquid assets and collateral arrangements to meet margin and collateral calls,
   - Active, transparent, and regular interactions with counterparties and third-party service providers in collateralised transactions.

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?**

As per our answer above, we believe that the focus of the FSB's policy recommendations on liquidity risk management and governance, stress testing and scenario design, and collateral management practices is appropriate. The WFE also encourages standard setters to consider the knock-on effects on NBFI from standards outside of those for which non-bank market participants are directly subject, such as the proposed Basel III Endgame rules. As highlighted in our December 2023 response, these proposals would likely cause non-bank market participants to face increased pressure in terms of credit afforded by intermediaries facing larger capital requirements. This could make it harder for non-bank market participants to plan for liquidity preparedness, as liquidity could vary more sharply and be more unpredictable. This adds to the consequences that would stem from a potential reduction in access to clearing for non-bank market participants overall. These consequences would be particularly likely if the Basel III Endgame proposals prompt a further consolidation in the number of intermediaries providing access to central clearing.

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

The WFE broadly agrees that non-bank market participants' liquidity risk management systems should be aligned with their size and role in the financial system, as well as the complexity of their activities and liquidity risk profile.

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?

The WFE believes the key elements are generally sufficiently clear and agrees that non-bank market participants should assess the liquidity risk that may arise from margined and collateralised transactions that could impact their business during times of stressed market conditions. The WFE wishes to highlight that many market participants already implement liquidity risk management frameworks to effectively manage their risks. Furthermore, this is bolstered by CCPs rules for clearing members that cover liquidity risk management. However, it is important to reaffirm that market participants should consider their risk profile and idiosyncratic vulnerabilities, as well as their role in the financial system to assess the materiality of liquidity risk propagating from margined and collateralised transactions. The WFE particularly recommends that non-bank market participants' liquidity risk governance frameworks clearly define how decision-making processes and early warning indicators of stress related to margin and collateral are addressed (and by whom).

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

The WFE believes these elements are generally sufficiently clear and sufficiently specified.

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

No comment.

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?

Yes, the WFE believes that the FSB's recommendations in Section 3.3 generally address the key elements required for participants to be effective in mitigating liquidity risk arising from margin and collateral calls. The WFE strongly recommends that non-bank market participants 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. Once again, many market participants already implement collateral readiness practices, which are often reinforced by CCP rulebooks. The WFE recommends that non-bank market participants should have active, transparent, and regular bilateral interactions with their counterparties and with third-party providers of collateral management services.

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

The WFE believes that non-bank market participants are well-equipped to implement the practices outlined in the report. The WFE agrees with the FSB that non-bank market participants must ensure that adequate risk management frameworks are in place to meet margin and collateral calls even when there are multiple stakeholders in the decision-making process (such as advisors, trustees, company management, and fund managers etc).

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

The WFE notes that on page 3 of the Report, the FSB list CCPs as entities who could help clients better prepare for spikes in margin and collateral calls by providing greater transparency on their margining practices. On this point, we wish to re-emphasise our feedback on the *Review of Transparency and Responsiveness of Initial Margin in Centrally Cleared Markets*, namely that CCPs already provide an enormous amount of transparency to the market, which is often not fully digested by participants[1], and that regardless of how much information CCPs disclose, market participants must be willing to use the available data to prepare for changes in margin levels.

However, greater transparency should be provided by non-bank market participants to CCPs, especially regarding the accumulation of materially large exposures of non-cleared positions, to protect against extreme stress or black swan events. The WFE looks forward to engaging with the FSB further on this topic.

[1] For example, PQD webinars are frequently offered by CCPs in order to discuss their reporting and margin methodology, but these are sparsely attended.