AMIC
Asset Management & Investors Council
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ICMA
International Capital Market Association

NBFI Macroprudential Framework for Bond Market Activity
ICMA position paper

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Executive Summary

Overview

- **The universe of so-called non-bank financial intermediaries (NBFIs) is inherently heterogenous.** To some extent, all of these undertake some bank-like activity, albeit pursuing different objectives and strategies, and all play a role in financing economies. Furthermore, all of these entities are subject to varying degrees of regulation and transparency which may differ across the jurisdictions in which they operate.
- **It may therefore be difficult to assess fully the risks that some of these entities could pose to wider financial stability,** whether as a result of a deterioration in market liquidity and functioning or as a consequence of excessive leverage, particularly where they operate on a cross-border basis.
- Increasingly the diverse spectrum of NBFIs play an active and crucial role in liquidity provision and funding in core markets, such as those for government bonds. **It is imperative that such entities are not deterred from these markets, while at the same time ensuring market stability.**
- **ICMA believes that the answer to this is to create a more even, but proportionate, playing field with respect to non-bank regulatory reporting, as well as a cross-jurisdictional framework for the sharing of regulatory data and the coordination of market surveillance.**

Liquidity and market functioning

- **Asset managers and investment funds are already governed by very robust regulatory frameworks,** which have also recently been reviewed and enhanced at both EU and global levels including addressing the potential for liquidity mismatches in OEFs.
- **The existing EU MMFR already imposes rigorous rules on management between the assets and liabilities of the fund** through compliance of liquidity ratios (daily and weekly), adapted to the various types of MMFs. The existing liquidity ratios have proven their resilience during the COVID crisis as no major failures were observed despite challenging conditions. Delinking, which is widely supported by the industry and policy makers, would further increase the resilience of those MMFs which are subject to the link between liquidity levels and LMTs.
- Given the current licensing as well as depth of monitoring and reporting concerning the regulated NBFI entities and activities, systemic liquidity risk is most likely to materialise in the activities which are less monitored and are less known. In order to manage effectively any potential systemic liquidity risk, **there needs to be greater monitoring and oversight over the less monitored or non-regulated entities and activities where systemic risk is most likely to materialise.**

Addressing excessive leverage in NBFIs

- Derivatives can be an important tool for investors to hedge both market and liquidity risks. Their impact is dependent on how they are **funded and** used (hedging of risk vs taking risk exposure) and the type of NBFI entity. **Leverage is therefore a fundamental feature of bond markets, helping to support both liquidity and risk management.**
- Any policy measures intended to manage risks to market stability as a result of excessive leverage therefore need to take into account the underlying entity types deploying leverage, the motives and strategies underlying the use of leverage, the sources of leverage, as well as the relative quantum of leverage. Furthermore, **this only becomes meaningful when assessed at a holistic, system-wide level.**
- **Much has already been done to limit the creation, provision, and use of leverage in financial markets,** in many cases as a considered trade-off with market liquidity. Banks, as the principal providers of leverage to non-banks, are subject to strict capital and leverage requirements under the Basel III framework.

- **With respect to OEFs, ICMA does not consider that there are any excessive leverage concerns, and this is recognised at both global (IOSCO) and EU levels.** At the EU level, UCITS funds have to comply with a leverage cap of 100% and a borrowing cap of 10%. AIFMs have to demonstrate that the leverage limits for each AIF they manage are reasonable and that they comply with those limits at all times.
- ICMA urges extreme caution with the introduction of blanket activity-based measures intended to curb leverage, either in isolation or in combination. In particular, **ICMA is not supportive of mandatory central clearing for bonds and securities financing transactions (SFTs), nor the imposition of minimum haircuts for SFTs.** [See pages 10-12]

Monitoring and supervisory coordination

- To address potential sources of systemic leverage, which is already well contained within the highly regulated NBFI sector, as well as other NBFI-related risks to financial stability, ICMA considers that the priority focus should be on **developing the effective monitoring and supervision of the wider NBFI universe through market surveillance, and cooperation, by way of system-wide, cross-border, systemic counterparty risk monitoring.**
- **Streamlining disclosures and the information sharing process for NBFIs with their bank counterparties** would help to increase transparency and facilitate the assessment of risk profiles and improve wider counterparty credit risk management functions.

Other measures to address liquidity risk

- There are a number of additional measures that authorities could consider in order to address liquidity risk faced by NBFIs. **These include expanding collateral eligibility to meet margin requirements, removing barriers to NBFI access to central clearing for SFTs, and taking steps to support secondary market liquidity both in the core sovereign bond markets and short-term markets.** [See pages 15-16]

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Introduction

The universe of so-called non-bank financial intermediaries (NBFIs) is inherently heterogenous. Entities that can be classed as NBFIs include open-ended investment funds (OEFs), close-ended funds (CEFs), money market funds (MMFs), insurance companies, pension funds, hedge funds (HFs), sovereign wealth funds (SWFs), securitisation vehicles, private equity and debt firms, stock exchanges and clearing houses, multilateral development banks (MDBs), microfinance institutions, and family offices. To some extent, all of these undertake some bank-like activity, albeit pursuing different objectives and strategies, and all play a role in financing economies. Furthermore, all of these entities are subject to varying degrees of regulation and transparency which may differ across the jurisdictions in which they operate. It may therefore be difficult to assess fully the risks that some of these entities could pose to wider financial stability, whether as a result of a deterioration in market liquidity and functioning or as a consequence of excessive leverage, particularly where they operate on a cross-border basis.

ICMA believes that the answer to this is to create a more even, but proportionate, playing field with respect to non-bank regulatory reporting, as well a cross-jurisdictional framework for the sharing of regulatory data and the coordination of market surveillance.

ICMA does not believe that applying a one-size-fits-all macroprudential framework to non-banks, or additional layers of prudential regulation to banks, is an appropriate or proportionate solution to what is in effect an issue with market oversight.

ICMA would add that rigorous rules, at least in the EU context, already apply to asset management firms, OEFs, and MMFs, which make further measures unjustified. Meanwhile, more can be done to help promote market liquidity and resilience, address risks related to procyclicality, and remove barriers to central clearing.

Liquidity and market functioning

Open-ended funds

Asset managers and investment funds are already governed by very robust regulatory frameworks that have also recently been reviewed and enhanced at both EU and global levels including addressing the potential for liquidity mismatches in OEFs.

The revised AIFMD and UCITS frameworks will introduce additional reporting requirements, make the full LMT toolkit available across all jurisdictions and mandate funds to select at least two LMTs from the list (Annex V of AIFMD and Annex IIA of UCITS Directive). This will support in further enhancing existing liquidity risk management practices and harmonise practices across the EU. ESMA is working on the detail of the characteristics and the selection and calibration of these LMTs via level 2 and level 3 measures which are scheduled to be adopted in April 2025.[1] The ECB and national central banks already receive very extensive data on the detailed assets and liabilities of each individual investment fund, particularly AIFs and UCITS, in the form of fund inventories. In order to equip NCAs with the ability to monitor better the liquidity profiles of OEFs, ESMA and the NCAs should be granted access to the data that the ECB and national fund managers already receive on a monthly and quarterly basis. Moreover, a new supervisory reporting regime will be introduced via the revised UCITS Directive and ESMA is due to publish a review of AIFMD supervisory reporting. It would be prudent to wait for the forthcoming implementation of the revised AIFM and UCITS Directives, and the outcome of the ESMA review, before considering any further additional reporting requirements.

It is also important to note that regarding regulated OEFs, NCAs review and approve key legal documents, such as the prospectus and the key information document, prior to the launch of a fund which includes the liquidity risk and liquidity risk management policy. It is also common practice for the fund managers to enter into discussions with their NCAs during this pre-authorisation phase, to discuss the proposed fund structure, liquidity structure and how they would respond in times of market stress. The final structure and relevant liquidity risk management processes are thus agreed between the fund managers and their NCAs prior to launching a fund[2] and once the funds are launched, securities regulators are responsible (along with fund managers) to monitor in practice the compliance with such legal commitments.

Money market funds

The existing EU MMFR already imposes rigorous rules on management between assets and liabilities of the fund through compliance of liquidity ratios (daily and weekly), adapted to the various types of MMFs (CNAV, LVNAV, VNAV). The existing liquidity ratios have proven their resilience during the COVID crisis as no major failures were observed despite challenging conditions. Delinking, which is widely supported by the industry and policy makers, would further increase the resilience of those MMFs which are subject to the link between liquidity levels and LMTs.

ICMA does not support the suggestion to increase liquidity buffers during times of stress. This would be counterproductive and would create procyclicality risks, where funds would be forced to sell out of assets during stressed conditions causing a spiralling, fire-sale situation. In times of stress, it is vital that MMFs are able to access their liquidity and avoid the risk of any second order effects.

Moreover, there are a number of drawbacks in giving competent authorities powers to increase liquidity buffers on a collective basis:

- NCA intervention risks being negatively interpreted by unit and shareholders who may then be incentivised to redeem their units/shares which could create a first-mover advantage.

1 ESMA published draft implementing rules on Liquidity Management Tools for funds on March 15, 2025
2 https://www.icmagroup.org/assets/documents/Regulatory/AMIC/AMIC-EFAMA-Managing-fund-liquidity-risk-in-Europe-2020-220120.pdf

- Increasing cash buffers may complicate the funds liquidity risk management.
- Collective increases may be perceived as poor MMF performance and push investors to use other products in which to hold their cash, which are less regulated than MMFs.

Increases on an individual level might only be feasible if this intervention can be undertaken on a confidential basis so to avoid triggering any negative market reactions and redemptions.

The focus should be on the use of LMTs to mitigate any potential risks rather than supervisory intervention via increasing liquidity buffer requirements. LMTs are also able to address the risk of first mover advantage more effectively than increasing liquidity buffers by reducing the incentive to redeem early and ensuring fair treatment of investors. The upcoming AIFMD and UCITS revisions will also require MMFs to select at least one LMT by 2026.

Moreover, to make liquidity more usable, it is important to facilitate the delinking of regulatory thresholds from the activation of LMTs and for MMF managers to feel comfortable to use their liquidity buffers when necessary.

Finally, having better knowledge of end-investors is also a relevant tool to better anticipate end-investor behaviour and avoid any substantial outflows.

Other NBFIs

Given the current licensing as well as depth of monitoring and reporting concerning the regulated NBFI entities and activities, systemic liquidity risk is most likely to materialise in the activities that are less monitored and are less known. In order to manage effectively any potential systemic liquidity risk, there needs to be greater monitoring and oversight over the less monitored or non-regulated entities and activities where systemic risk is most likely to materialise.

Given that these entities are not currently subject to the same monitoring and reporting requirements as the highly regulated NBFIs and banks, it is important that authorities complement banks' due diligence and counterparty risk assessments with a system-wide cross-border systemic counterparty risk monitoring. The Archegos collapse, by way of example, might have been mitigated if authorities were equipped with monitoring tools allowing detection of concentrated positions spread across several banks.

Addressing excessive leverage in NBFIs

Derivatives can be an important tool for investors to hedge both market and liquidity risks. Their impact is dependent on how they are **funded and** used (hedging of risk vs taking risk exposure) and the type of NBFI entity. **Leverage is therefore a fundamental feature of bond markets, helping to support both liquidity[3] and risk management.**

Any policy measures intended to manage risks to market stability as a result of excessive leverage therefore need to take into account the underlying entity types deploying leverage, the motives and strategies underlying the use of leverage, the sources of leverage, as well as the relative quantum of leverage. Furthermore, this only becomes meaningful when assessed at a holistic, system-wide level.

Entity based measures

Much has already been done to limit the creation, provision, and use of leverage in financial markets, in many cases as a considered trade-off with market liquidity. Banks, as the principal providers of leverage to non-banks are subject to strict capital and leverage requirements under the Basel III framework, including the Leverage Ratio, Supplementary Leverage Ratio, Risk-Based Capital Requirements, Counterparty Credit Risk Weightings, Capital Buffers, Liquidity Requirements, as well as Supervisory Review and Stress Testing. Some of these requirements are still in the process of being implemented across various jurisdictions and it is still too early to assess their full and combined impact both on systemic leverage and market liquidity.

With respect to OEFs, ICMA does not consider that there are any excessive leverage concerns, and this is recognised at both global (IOSCO) and EU levels. At the global level, in its 2023 Investment Fund Statistics Report,[4] IOSCO concluded that *"OEFs do not have large aggregate exposures through derivatives positions, and consequently, are not leveraged by any meaningful impact"*. IOSCO has also most recently reviewed the liquidity risk management (LRM) toolkit via its Guidance on Anti-dilution LMTs (December 2023)[5] and is now working with the FSB, via the FSEG, to identify financial stability risks, stemming from leverage in NBFI. The FSB has consulted on policy approaches to address systemic risk from NBFI leverage to which ICMA has responded, and the FSB is now expected to publish final policy recommendations in July 2025.

At the EU level, UCITS funds have to comply with a leverage cap of 100% and a borrowing cap of 10%. AIFMs must demonstrate that the leverage limits for each AIF they manage are reasonable and that they comply with those limits at all times. The total amount of leverage employed is reported to the supervisors (with enhanced reporting obligations for leverage exceeding 300%) and also disclosed to investors. For ELTIFs, borrowing is limited to 100% of NAV. Article 25 of the AIFMD grants the competent authorities the ability to impose leverage limits, or other AIF management restrictions, to contain any possible buildup of systemic risk attributed to leverage. For instance, this is a power that has been successfully deployed by the Central Bank of Ireland in relation to Irish domiciled real estate funds in November 2022, and more recently in April 2024 on GBP LDI funds in coordination with Luxembourg's CSSF.

ESMA also has liquidity stress testing guidelines[6] which require managers to ensure that they are prepared to meet redemptions and liquidity demands arising from margin calls. ESMA has recently assessed risks posed by leveraged AIFs in the EU17 and has concluded that NCAs have the right tools to provide an accurate view of risks in their jurisdiction.

3 See: Hedge funds: good or bad for market functioning?, ECB, 23 September 2024
4 See: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD725.pdf
5 See: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD756.pdf
6 See: https://www.esma.europa.eu/sites/default/files/library/esma34-39-882_final_report_guidelines_on_lst_in_ucits_and_aifs.pdf

Activity based measures

ICMA urges extreme caution with the introduction of activity-based measures intended to curb leverage, either in isolation or in combination. In particular, ICMA is not supportive of mandatory central clearing for bonds and securities financing transactions (SFTs), nor the imposition of minimum haircuts for SFTs. Rather, ICMA sees these as potentially introducing new risks and market inefficiencies that could undermine market stability. While the repo market can be used as a source of leverage, its smooth functioning is fundamental to overall market stability: being used as a means of secure lending and borrowing; facilitating collateral and liquidity management; supporting secondary market liquidity and pricing for bonds and derivatives; and providing the primary channel for monetary policy transmission. Any measures that adversely affect the normal functioning of the repo market can have serious negative consequences for the wider financial market and broader economy. It is therefore important that any activity-based measures are targeted, temporary, and informed by data.

Central clearing of securities financing transactions

ICMA is fully supportive of removing regulatory barriers to non-bank access to central clearing for outright and repo transactions in appropriately liquid cash securities, such a government bonds. Central clearing provides several potential benefits in the context of SFTs, including increased settlement efficiency and improved access to market liquidity. However, ICMA opposes the notion of mandating central clearing for cash securities, noting that the decision to clear should be based on commercial considerations and sound risk management without undue constraints. There are several reasons why ICMA considers the recommendation of mandating central clearing for SFTs to be misguided and risky.

Firstly, it is not entirely clear whether increasing clearing for SFTs would help to constrain leverage. Different models exist to facilitate non-bank access to a CCP. In some models, the sponsoring or agent bank posts the initial margin, which would defeat the main argument underlying the recommendation. Also, cross-product margining arrangements provided by many CCPs, which requires margin against a net exposure, could actually increase the availability of leverage to some entities.[7] For example, the much-reported basis trades popular with certain investor types (which involve both a bond futures and repo position) could be more efficiently (i.e. cheaply) margined if the repo is centrally cleared, compared to it being transacted bilaterally.

Secondly, and very importantly, mandating central clearing for SFTs would introduce procyclicality risks to the market. As already highlighted, the repo market in particular is an important source of market stability, facilitating short term liquidity and collateral transformation. Financial institutions (bank and non-bank) rely on the repo market in order to meet margin calls against their derivatives exposures, which are often hedges. By subjecting repo positions to the risk of significant spikes in variation margin in times of heightened volatility, compared to bilateral repo arrangements, would require even more collateral being mobilised to raise cash to meet margin calls more broadly. This is particularly pertinent in the case of non-bank entities that are predominantly one-directional in terms of repo activity (i.e. lending securities to raise cash), such as pension funds. This would heighten the probability of margin calls being missed, so increasing counterparty credit risk, while diminishing the repoable value of institutions' high quality liquid assets, thereby increasing market risk.

Thirdly, it is important to recognise the important role that the repo market plays in maturity transformation, allowing financial institutions to secure term funding against their assets. Centrally clearing term repo trades, without the potential for margin netting, can be prohibitively expensive due to the high levels and associated uncertainty of variation margin. This creates a natural bias to very short-dated repo transactions when centrally cleared, which can be observed, for instance, in the US Treasury repo market. Mandating central clearing for SFTs would severely restrict the ability of many non-banks to access term funding, creating a systemic reliance on very short-dated repo financing. Such a lack of diversity in financing tenors would be an additional risk to financial stability, particularly in the case of short-term funding shocks.

7 However, it should be noted that *cross*-product margining is not specific to centrally cleared transactions, and that this has been a standard feature of Prime Brokerage arrangements for several decades.

Fourthly, and also associated with the relative cost of transacting cleared SFTs compared to bilaterally, this would create a potential barrier to accessing the repo market. It is often purported that CCPs create more balance sheet netting opportunities for banks, which should help support more intermediation and deeper liquidity. However, recent studies reveal that on average the benefits of uniform clearing would be relatively modest and largely limited to very short-dated repo.[8] What receives less attention is the fact that increasing banks' exposures to CCPs would also have impacts with respect to liquidity, risk weighted capital, and single counterparty credit limits. In other words, the Leverage Ratio is not the only limiting constraint on banks' balance sheets. For many non-banks, the cost of clearing SFTs will be prohibitively expensive. As with minimum haircuts for bilateral transactions, consideration needs to be given to the impact on pricing, liquidity, intermediation, and investor diversification in the underlying market, as well as the wider impacts on government borrowing costs not to mention financial stability.

While some jurisdictions are beginning to explore the possibility of mandating central clearing for government bond markets, many will share the concerns we have outlined and will most likely wait to assess the impacts and lessons learned of its projected implementation in the US. ICMA would therefore, as a minimum, suggest waiting for the full effect of the US mandate to be realised and digested before recommending broad adoption.

Minimum haircuts in securities financing transactions

ICMA does not support the introduction of minimum haircuts for securities financing transactions for a number of reasons.

Firstly, it is important to recognise that a capital-based regulatory framework already exists that effectively contains the ability of banks to provide leverage to non-banks. This includes the application of capital risk weightings that are calibrated for both the counterparty and the collateral, both in the standardised approach (SA) and banks' internal models (IM). Furthermore, the introduction of the Output Floor (OF) will effectively increase the risk weightings currently applied under IMs. If market authorities have reason to believe that the current regulatory framework, including measures still to be implemented, does not serve its purpose, then it should review the existing calibration rather than introducing additional layers of regulation.

Secondly, a minimum haircut framework would suggest that all non-bank counterparties are alike. As previously highlighted, NBFIs cannot be grouped together and assessed as a homogenous entity. In reality, NBFIs have very different risk and leverage profiles, and use SFTs for a variety of purposes. Thus, a one-size-fits-all solution would not be appropriate. For a minimum haircut framework to even begin to make sense it would need to be calibrated to account for the specific counterparty risk, which is essentially what the existing regulatory risk capital framework seeks to do.

Thirdly, while haircuts are intended to manage the liquidity risk of the underlying securities (i.e. liquidation risks in the event of default), they have a direct impact on counterparty credit risk. In the case of applying minimum haircuts, this could be distortive. Specifically, an NBFI of higher credit quality than a counterparty bank would be increasing its credit risk to the bank as a result of being charged a haircut. This would increase overall credit risk in the system, counter to the objectives of the policy.

Fourthly, applying minimum haircuts to individual trades does not support the objective of containing overall counterparty leverage. In determining the haircut policy for different SFT transactions with various counterparties, banks make their assessments based on the total aggregate exposure to the counterparty and the cost of capital associated with doing business, and not purely at the individual transaction level. For example, a prime broker may hold significant assets in custody for a client compared to the amount of leverage being provided. In this instance it is not clear, from an overall leverage perspective, what would be achieved by applying a minimum haircut to an individual repo transaction, other than making the trade, in itself, more expensive for the client.

8 See: Balance-Sheet Netting in U.S. Treasury Markets and Central Clearing, David Bowman, Yesol Huh, and Sebastian Infante, Federal Reserve Board, June 2024; and The potential impact of broader central clearing on dealer balance sheet capacity: a case study of UK gilt and gilt repo markets, Yuliya Baranova, Eleanor Holbrook, David MacDonald, William Rawstorne, Nicholas Vause, and Georgia Waddington, Bank of England, June 2023

Fifthly, as highlighted in some of the previous points, mandatory minimum haircuts would simply make the cost of transacting SFTs more expensive for non-banks, regardless of their risk or leverage profile, or their motivation for participating in the market. Increasing minimum haircuts for SFTs will create additional costs and frictions in normal market conditions that would become even more pronounced in times of heightened volatility or market risk, thereby feeding procyclicality risk. SFT markets, particularly the repo market, are a source of market stability, facilitating short-term liquidity management and collateral transformation. Adding costs and frictions to the market, particularly in times of heightened volatility or market stress, would seem to be counterproductive to the objective of maintaining financial stability, and could even exacerbate fire-sales or 'dash-for-cash' scenarios, as market participants struggle to meet increasing margin calls. Which raises the question of whether a countercyclical approach to SFT haircuts would make more sense from a market stability perspective (i.e. maximum haircuts).

Finally, and related to the additional cost to transacting SFTs as a result of minimum haircuts, consideration also needs to be given to the impact on the underlying market, not least core government bond markets. A more expensive and less liquid repo market, with fewer participants, will have a knock-on impact in the outright market, widening bid-ask spreads in the secondary market and new issuance premium in the primary market. Accordingly, the seemingly limited benefits of minimum haircuts also need to be assessed against the wider macroeconomic impacts of raising sovereign borrowing costs, as well as any unintended consequences for financial stability.

It is also important to note that the BCBS's Minimum Haircut Framework has not been implemented in any of the large financial market jurisdictions given in part due to the concerns highlighted above, combined with concerns[9] about the efficacy of the framework itself.

9 See: https://www.icmagroup.org/assets/documents/Regulatory/Repo/GFMA-and-ICMA-Repo-Market-Study_Post-Crisis-Reforms-and-the-Evolution-of-the-Repo-and-Broader-SFT-Markets_171218.pdf

Monitoring and supervisory coordination

To address potential sources of systemic leverage, which is already well contained within the highly regulated NBFI sector, as well as other NBFI-related risks to financial stability, ICMA considers that the priority focus should be on developing the effective monitoring and supervision of the wider NBFI universe through market surveillance, and cooperation, by way of system-wide, cross-border, systemic counterparty risk monitoring (to be conducted jointly by authorities, i.e. market authorities and banking supervisors), leveraging existing data as a priority to avoid any additional burden.

Regulatory reporting

ICMA considers the starting point for the most effective monitoring of financial stability risks should be the prioritisation of the effective use of data through the existing reporting requirements, such as the derivatives and SFTs reporting requirements, but also margin transparency. Where extensive reporting frameworks already exist (e.g. EMIR, MAS, ASIC, MIFID for derivatives, SFTR, OFR for SFTs), authorities should be well placed to identify build-ups of leverage or concentration exposures.

System-wide stress testing

Regulatory monitoring of financial stability risks at the macro-level is an important complement to the due diligence, monitoring and risk management conducted by individual financial institutions. The Bank of England System-wide exploratory scenario (SWES) exercise[10] is a good example of system wide monitoring, and ICMA would consider a system wide solution to be the most appropriate tool to monitor financial stability risks resulting from the different variants listed in the question.

Unlike the stress-tests that central banks and regulatory authorities conduct on an annual basis to assess the resilience of each individual firm, the system wide assessment includes a much broader range of market participants in order to understand the interactions between the different types of financial institutions and the potential amplification of shocks. This facilitates the identification of any risks to and from NBFIs and any system-wide vulnerabilities which could impact financial stability.

To ensure the effectiveness of a system-wide exercise, we advise on certain conditions that should be met to ensure its effectiveness:

- System-wide tests should have a well-defined objective, focusing on how all market participants affect a specific market under a particular scenario.
- These tests should serve as information-gathering tools, not as a means to establish macroprudential policies for non-banks or to set prescriptive rules for individual firms (e.g. liquidity ratios or prudential requirements for banks).
- Supervisors should not make assumptions about market participant behaviour.
- Responses to scenarios should be based on participants' real-world experience, rather than hypothetical simulations created by supervisory authorities.
- It is important to acknowledge that each participant's behaviour and options will be influenced by their counterparties' decisions and reactions, as well as policymaking and the regulatory framework they operate under. Understanding these interdependencies is crucial to make any accurate assessments.
- It should be proportionate and have a defined time frame. Given the data and resource intensive nature of these tests for firms, they should not be conducted any more frequently than on a 5-year basis.

10 https://www.bankofengland.co.uk/financial-stability/boe-system-wide-exploratory-scenario-exercise

- Given the global nature of financial markets, jurisdictions should coordinate their assessments to help identify and mitigate any potential cross-border system risks. This coordination is also important in order to avoid excessive regulatory burden on financial market participants.

Counterparty disclosures

There are already extensive regulatory frameworks governing disclosure requirements between banks and their counterparties in the existing Basel CCR framework and authorities should prioritise implementing the recently enhanced BCBS guidelines for Counterparty Credit Risk Management before considering any further disclosure enhancements.

The issue in the case of the often-cited Archegos collapse was the failure of their banking counterparts' risk management practices and the inadequate implementation of existing counterparty risk requirements. The final guidelines, published in December 2024, address these concerns by emphasising the need for comprehensive due diligence, both at initial onboarding and on an ongoing basis. This approach ensures banks have a full understanding of the risks they are taking before making key credit risk decisions and that they can act swiftly with sufficient information on changing risk profiles during times of stress.

Given that banks already request at least a minimum set of disclosures from each counterparty which can be enhanced as necessary on a bilateral basis (or the banks can refuse to trade with the NBFI if adequate information is not provided), and that leverage users, particularly the highly regulated fund sector, already share financial information on their exposures with prime brokers at regular intervals, streamlining the information sharing process would greatly benefit all counterparties.

By streamlining information sharing processes and standardising reporting templates this would increase transparency, facilitate the assessment of risk profiles, and improve wider counterparty credit risk management functions.

Other measures to address liquidity risk

There are a number of additional measures that authorities could consider in order to address liquidity risk faced by NBFIs.

Margin eligibility

Risks related to NBFI position liquidation often arise as a result of the regulations relating to the counterparty credit risk channel which can require margining which may be limited in terms of eligible collateral. The FSB, BCBS, CPMI, and IOSCO have conducted extensive work on this topic over recent years, with a focus on addressing transparency and responsiveness of margin requirements in cleared and uncleared markets. Further enhancements would be best addressed by widening the scope of eligible collateral that is permitted and for this to be supported by margining rules.

Apart from encouraging the use of government bonds and other highly liquid assets as an alternative to cash collateral for variation margin, meaningful extensions of eligibility include MMF units, as well as, in the EU context, the ability of UCITS to re-use reversed collateral.

Access to central clearing

As previously mentioned, central clearing provides several potential benefits in the context of SFTs, including increased settlement efficiency, and improved access to market liquidity. Accordingly, ICMA supports the removal of regulatory barriers to NBFI access to clearing. Here ICMA promotes two key regulatory initiatives.

Firstly, in the EU context, UCITS Regulation should be revised to exclude CCP cleared transactions from relevant concentration and diversification requirements, both in the case of direct and indirect clearing models. The advantage would be to make the use of central clearing less restrictive for UCITS regulated funds without putting constraints on their use of bilateral markets.

Secondly, providing capital efficiency for clearing agents through cross-product netting. Many CCPs already offer cross-product netting, such as swaps and repo, to support margin efficiencies. However, under the Standardised Approach (SA), the Basell III framework (as implemented by the CRR in the EU), does not provide for cross-product netting to be recognised for the purposes of counterparty credit risk capital requirements. And while internal models (IM) do allow for capital netting where permission has been granted by the regulator, the application of the Output Floor would mean that banks are effectively constrained by their SAs. From the perspective of agent clearers, this inefficiency creates additional capital costs which are a disincentive to client clearing, or need to be passed on to clearing clients. An amendment to the Basel rules to provide for recognition of cross-product netting of centrally cleared SFT and derivative transactions would help to increase the efficiency and attractiveness of SFT clearing both for NBFIs and clearing agents.

Supporting secondary market liquidity in core markets

Liquidity in the core sovereign bond markets remains a key focus of both public and private stakeholders particularly due to its importance for collateral and liquidity management. The ability of the market to absorb large volumes under stressed conditions, both in the outright and repo market, without triggering procyclical fire sales, is fundamental to market stability.

In the 2023 report, *Liquidity and resilience in the core European sovereign bond markets*,[11] ICMA explores potential threats to market resilience in the German, French, Italian, Spanish, and UK government bond markets. The report is based on extensive data and quantitative analysis as well as interviews with market participants, including market makers and investors.

11 Liquidity and resilience in the core European sovereign bond markets, ICMA, March 2024

ICMA's analysis concludes that, generally speaking, liquidity in sovereign bond markets is good. But in periods of stress liquidity evaporates rapidly. Liquidity provision during times of heightened volatility usually becomes concentrated among the larger banks, as many broker-dealers are forced to reduce their balance sheets (potentially giving rise to concentration risk), and as a direct consequence of bank prudential regulation. Furthermore, dealers tend to restrict their liquidity provision to their larger and more profitable clients. The report concludes that there is a trade-off between higher levels of bank capital and market liquidity, particularly in times of stress and heightened volatility.

There remains a discussion to be had between prudential and market regulators on how the prudential framework as it applies to primary dealers in core sovereign bond markets can be calibrated better to support liquidity provision, particularly in times of heightened volatility. One such consideration is the exclusion of government bonds from the Leverage Ratio and Supplementary Ratio calculations.

Supporting secondary market liquidity in short-term markets

In its analysis of the European commercial paper and certificates of deposit market published in September 2021,[12] ICMA notes that perhaps one of the starkest realisations from the March-April 2020 turmoil is how thin and vulnerable the secondary market is for CP in stressed market conditions. While CP is generally considered to be a buy-to-hold, often matching investors' short-term liquidity horizons, its value as a money market instrument also hinges on its liquidity post-issuance, particularly in times of market stress. The fact that CP is a low margin, capital intensive business does not make it conducive to secondary trading; not least when banks' capital becomes a scarce resource.

There are a number of possible public sector initiatives that could help to develop a functional, liquid secondary market, including:

- Capital and liquidity relief under the Basel rules to enable dealers to hold inventory, particularly in times of market stress. The Federal Reserve's move to provide capital relief to banks buying back eligible assets under the MMLF[13] was both critical and immediate in stabilising the US CP market in March 2020. Recognising highly rated CP as High Quality Liquid Assets (HQLA) in capital ratios would at least be a positive step.
- A clearly defined 'back-stop' central bank purchase programme that provided a predictable 'bid of last resort' for a broad range of European CP (including financial and ABCP) would allow dealers to continue to support markets, particularly at times when balance sheet is restricted (such as over reporting periods), but more importantly in times of market stress.
- Broader central bank eligibility of CP in money market operations would enhance the repo-ability of CP and provide another funding option for dealers, particularly for financial CP/CDs and ABCP.

12 The European Commercial Paper and Certificates of Deposit Market, ICMA, September 2021
13 See: https://www.federalreserve.gov/monetarypolicy/mmlf.htm

Conclusion

Non-bank financial intermediaries (NBFIs) are defined by what they are not, rather than by what they are, and accordingly form a highly diverse universe of entities that to some degree or another may engage in some bank-like activity, and which are subject to varying depths of regulatory requirements across different jurisdictions. Without comprehensive and cohesive regulatory oversight of their structures, activities, and interdependencies, it is difficult to assess the extent to which these may contribute to the build up of liquidation risk or excessive leverage which could pose a threat to market stability.

While stringent regulatory requirements aimed at limiting liquidity management risks and leverage already exist for many NBFIs, such as OEFs and MMFs, banks, as the main providers of both market liquidity and leverage, are highly regulated and activity-constrained through the Basel framework.

Adding new layers of regulatory requirements to the most regulated and transparent NBFIs would seem to be counterproductive. Similarly, activity-based measures that add cost, complexity, and frictions to SFT markets could do more to undermine market stability.

ICMA believes that most effective approach to identifying and managing potentially systemic risks arising from NBFIs starts with the use and sharing of the extensive regulatory reporting data that already exists, complemented with periodic system-wide stress testing.

Meanwhile, there are a number of direct measures that the authorities could take to reduce procyclicality, counterparty, and market risk that currently are not part of the NBFI discourse.

About ICMA

ICMA promotes well-functioning cross-border capital markets, which are essential to fund sustainable economic growth. It is a not-for-profit membership association with offices in Zurich, London, Paris, Brussels, and Hong Kong, serving over 620 members in 70 jurisdictions globally. Its members include private and public sector issuers, banks and securities dealers, asset and fund managers, insurance companies, law firms, capital market infrastructure providers and central banks. ICMA provides industry-driven standards and recommendations, prioritising three core fixed income market areas: primary, secondary and repo and collateral, with cross-cutting themes of sustainable finance and FinTech and digitalisation. ICMA works with regulatory and governmental authorities, helping to ensure that financial regulation supports stable and efficient capital markets.

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