Deutsche Börse Group response

to the
CPMI-IOSCO Report

on

Streamlining variation margin in centrally cleared markets – examples of effective practices

Frankfurt, 14 May 2024

1. Introductory Remarks

The CCPs Eurex Clearing and European Commodity Clearing (ECC) are part of Deutsche Börse Group (DBG). DBG appreciates the ongoing work of CPMI-IOSCO on harmonisation and centralisation of global standards for CCPs and the close cooperation with the relevant stakeholders to achieve the optimal degree of effective transparency. We have always committed to the importance of transparency of margining practices for market participants to predict liquidity needs. Against this background, we support the objective of the international standard-setting bodies to streamline variation margin in centrally cleared markets.

To begin with, we would like to highlight that Eurex Clearing offers its clients the opportunity to receive back excess liquidity intraday. Therefore, clients' liquidity risk management also benefits from receiving liquidity earlier than at the end of the day. Depositing excess collateral at the CCP provides clients the opportunity of fewer intraday margin calls, as certain degree of market price fluctuation can be covered. This reduces the liquidity risk for the clients. The trade-off between providing few excess collaterals to the CCP and lower liquidity risk by providing more excess collateral is a decision that must be made by the client. Therefore, it is crucial that CCPs retain flexibility to make intraday margin calls to ensure sufficient margin coverage at all times.

We would also like to note that the CPMI-IOSCO report primarily addresses the handling of VM, but not the potential issues when it comes to the calculation of VM. For ECC, as a CCP specialised in energy and commodity products used for hedging assets (e.g., power stations), the calculation is a significant factor when considering whether and how to make VM calls. Furthermore, energy and commodity products have a high structural price dependency. For an accurate VM calculation, prices are required that take these structural dependencies (e.g., across time or different delivery areas) into account. This means that the availability, quality, and reliability of intraday prices also shall be considered when determining the types and frequency of ITD VM. For less liquid products the frequency might be lower than for liquid ones.

Against this background, we agree that the proposed practices aimed at promoting transparency and advantageous offsetting (Practices 6 & 7) are both effective and without major disadvantages for the industry. However, the recommendations to use scheduled ITD margin calls and ITD pass through of VM (Practices 1 to 5) are debatable due to multiple unwanted effects for both CCPs and participants:

Practice 1: A high predictability of ITD margin calculations and collections is preferable to assess liquidity needs and enable participants to pass through margin calls. However, CCPs must always maintain control of their uncovered exposure and only using scheduled ITD calls would significantly limit the CCP's control and allow uncovered exposure to build up. As an alternative, predictability can be achieved by having clear and transparent rules relating to the trigger of a margin call and how margins are evaluated intraday. An event-driven approach may for instance be advantageous, only triggering ITD calls in case of position changes or adverse price movements resulting in margin changes exceeding transparent predefined thresholds.

Practice 2: CCPs should provide a margin call timetable that includes clear specification of an ITD call trigger as well as the time that the CCP provides Clearing Members to provide collaterals and collect VM. One way to increase predictability is for CCPs to provide Clearing Members with access to their intraday and/or real time margin calculations.

Practice 3: We believe that the practice is effective to a certain extent. Intraday offsetting of different payment obligations allows to reduce liquidity demands on participants while CCPs are still in control of the uncovered exposure. Once the offsetting of VM calls against other payment obligations is performed, the passing through of VM profits is not feasible without liquidity strains for the CCP.

Practice 4: While reviewing the feasibility of passing through ITD VM may be carried out, the effectiveness is uncertain. While participants may appreciate the review as it might ease their liquidity burden in certain scenarios, they would not appreciate being required to provide possibly illiquid currencies. Due to the lack of robust price determination conditions intraday, only settlement price approximations would be available for most products, making ITD VM settlements questionable. In addition, as any alternative collateralisation would not be possible anymore, participants would face new constraints during the day.

Practice 5: The use of intraday excess collateral allows to reduce liquidity demands on participants while CCPs maintain control of the uncovered exposure. However, a conservative assessment of collaterals is required as CCPs need to be able to convert collaterals quickly to handle default events efficiently.

Practice 6: Providing the proposed information helps participants to predict and manage liquidity requirements while CCPs remain in control of the uncovered exposure and providing transparency on processes. However, in case thresholds and timings are fully transparent, participants could manoeuvre along the thresholds to maximise capital efficiency, leaving the CCP with uncovered exposure.

Practice 7: Useful information whether timelines, thresholds and rules are appropriate helps CCPs to finetune their processes and preferences of the market can be incorporated by the CCPs. When it comes to the collection or collateralisation of ITD VM, the CCPs must not pile up uncovered exposure in form of VM losses to ensure functioning markets.

We trust that our comments are useful for CPMI-IOSCO's further policy work and are available for further discussion.

2. Detailed comments to the consultation report

1. ***Do you agree that the eight effective practices identified in this report foster market participants' preparedness for above-average VM calls through the efficient collection and distribution of VM in centrally cleared markets?***

While any recommendation to use scheduled ITD margin calls and ITD pass through of VM is debatable and needs to be considered carefully due to multiple unwanted effects for both CCPs and participants as outlined in the answers to the following questions below, the practices aimed at fostering transparency and beneficial offsetting are effective and without major drawbacks for the industry.

2. ***Are there any other effective practices, mechanisms or changes that would streamline VM processes in centrally cleared markets which have not been covered in this report? If so, please describe such practices.***

No comment

3. ***For each effective practice identified in this report:***
   a. ***Do you agree that it is an effective practice?***
   b. ***What are the pros and cons (including unintended consequences) of the effective practice?***
   c. ***Please discuss any drawbacks or hurdles to implementing the effective practice.***
   d. ***Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.***

3.1 Practice 1

Increasing the predictability of ITD margin calculations and collections to the extent practicable. This could be achieved by using, or increasing the frequency of, scheduled ITD margin calculations and collections where appropriate, after carefully considering the trade-off between the following: a. the increased operational burden associated with making more scheduled ITD calls, as well as the positive impact of using ad hoc calls when it is prudent; and b. the corresponding decrease in the probability of ad hoc ITD calls, as well as the positive impact on clearing members' operational readiness and financial capacity to meet the scheduled calls.

a. Increasing the predictability of ITD margin calculations and collections is preferable. However, DBG believes that the use of scheduled ITD calls needs to be considered carefully.
b. A high predictability of ITD margin calculations and collections is preferable to assess liquidity needs and enable participants to pass through margin calls. Predictability can be achieved by having clear and transparent rules relating to the trigger of a margin call and how margins are evaluated intraday. This could manifest itself either as scheduled margin calls (timing trigger) or event-driven margin calls (monetary trigger). The clear triggers for intraday margin calls allow them to be predictable as a function

of market developments, e.g., reflecting the adverse market moves and at the same time allows for timely mitigation of counterparty credit risk. Only using scheduled ITD calls would significantly limit the CCP's control and allow uncovered exposure to build up. Increasing the frequency of scheduled margin calls will also increase operational efforts. But CCPs would still be required to issue ad hoc ITD calls to fulfil EMIR requirements to call and collect margins on an intraday basis, at least when predefined thresholds are exceeded (Article 41 para. 3). When considering this trade-off, an event-driven approach may be advantageous, only triggering ITD calls in case of position changes or adverse price movements resulting in margin changes exceeding transparent predefined thresholds.

c. Increasing the predictability of ITD margin calculations and collections by providing transparency on predefined thresholds, ITD margin call drivers and reports does not pose hurdles. However, we want to raise attention that using or increasing the frequency of scheduled ITD margin collections requires significant implementation and operational efforts on participant and CCP side.
d. CCPs may offer a combination of voluntary scheduled collateralisation runs and event-driven margin calls in case of significant uncovered exposure exceeding CCP's thresholds. Nevertheless, an increased predictability of ITD margin calculations and collections can also be achieved by regular provision of ITD margin reports, margin changes limited to price and position change related (no margin parameter changes intraday), and upfront communication of thresholds triggering ITD margin calls. In this way, the CCP remains in control of its uncovered exposure while still ensuring a high degree of predictability of ITD margin calls.

3.2 Practice 2

Giving participants sufficient time to manage the liquidity impact of an ITD call, while also considering the need to collect VM on a timely basis in order to mitigate the build-up of current exposures.

a. DBG agrees that the proposed practice is effective.
b. CCPs should provide a margin call timetable that includes clear specification of an ITD call trigger (either time-based or based on uncollateralised exposures) as well as the time that the CCP provides Clearing Members to provide collaterals and collect VM. One way to increase predictability is for CCPs to provide Clearing Members with access to their intraday and/or real time margin calculations. In this way, Clearing Members can monitor the likelihood to get margin calls in advance.
c. Although excessive time to arrange funding may render CCPs incapable of identifying default events in a timely manner, sufficient time must be granted to avoid unnecessary liquidity strains for participants.
d. No comment

3.3 Practice 3

Where allowed, practical and efficient, offsetting VM calls against other payment obligations, such as initial margin calls and product payment flows (e.g., coupons), in order to reduce liquidity demands on participants.

a. DBG believes that the practice is effective to a certain extent.
b. Intraday offsetting of different payment obligations allows to reduce liquidity demands on participants while CCPs are still in control of the uncovered exposure. Such offsetting is most efficient if the VM and IM credits and debits are collapsed to a single currency. Once the offsetting of VM calls against other payment obligations is performed, the passing through of VM profits is not feasible without liquidity strains for the CCP. For end of day VM calls, CCPs need to ensure to be able to pass through VM calls according to a fixed schedule per currency which may require only limited offsetting options. As per practice, the practicality and efficiency shall be considered.
c. As alluded to in the introductory comments, Eurex Clearing already applies the practice of offsetting intraday VM calls against other payment obligations such as intraday IM calls, thus no additional implementation hurdles exist.
d. No comment

3.4 Practice 4

Reviewing its operational practices based on an evaluation of the feasibility and the pros and cons of passing through ITD VM to mitigate the liquidity impact of ITD calls on participants.

a. While reviewing the feasibility of passing through ITD VM may be performed, DBG believes that the effectiveness is uncertain. Considering the very specific conditions required to make passing through VM a viable option, the applicability is very limited.
b. We expect that participants may appreciate CCPs reviewing their operational practices regarding passing through ITD VM. Implementing passing through ITD VM might ease their liquidity burden in certain scenarios. Participants covering their ITD VM losses with non-cash collaterals, opposing payment obligations, or any preferred currency would, however, face disadvantages in case CCPs would require them to provide cash in the product currency intraday. Many participants using this option would not appreciate being required to provide possibly illiquid currencies for ITD VM. The practice relies on high quality, reliable and consistent price determination intraday, including instruments without continuous trading patterns. Due to the lack of robust price determination conditions intraday, only settlement price approximations would be available for most products, making ITD VM settlements questionable.
c. The implementation of passing through ITD VM adds operational burdens by adding multiple payment runs in various product currencies with multiple settlement schedules. Additionally, as any alternative collateralisation of ITD VM would not be possible anymore (not passing the VM intraday allows for use of non-cash collateral), participants would face new liquidity constraints during the day.
d. The application of Practices 3 and 5 may provide more advantages for both CCPs and participants but limit the applicability of Practice 4. Especially when offsetting ITD VM calls against excess non-cash collateral, passing through ITD VM is not feasible for CCPs. In addition to Practices 3 and 5, CCPs may allow the ITD withdrawal of excess collateral to a maximum extent as long as investment practices of the CCP are not impacted.

3.5 Practice 5

Subject to agreement with the CM or client and where legally and operationally feasible, allowing the use of excess collateral to meet ITD VM obligations.

a. DBG agrees that the proposed practice is effective.
b. Using intraday excess collateral to meet ITD VM obligations allows to reduce liquidity demands on participants while CCPs maintain control of the uncovered exposure. Additionally, the need for ITD margin calls is reduced. Vigilant and conservative assessment of eligible collaterals are required as CCPs need to be able to convert collaterals quickly to handle default events efficiently. However, there should be no special requirements for the use of intraday excess collateral compared to other types of collaterals. Once offsetting of VM calls against non-cash collaterals or cash collaterals denominated in a different currency, passing through VM profits is not feasible without liquidity strains for the CCP.
c. No comment
d. No comment

3.6 Practice 6

Providing information regarding the CCP's processes and timing for ITD VM calls in order to facilitate its participants' ability to predict and manage liquidity requirements. This could be achieved by clearly defining and making available to participants (through the CCP's rulebook or other relevant documentation) the following: a. the circumstances and any related thresholds according to which the CCP may make ITD VM calls; b. the timing and relevant notice periods for its ITD VM calls; c. the CCP's processes and rules concerning the netting of payments across margin accounts for each type of margin call, where excess collateral can be used to meet VM requirements, and any other provisions which have an impact on the amounts to be called from CMs; and d. granular information to help CMs understand the composition of VM calls, which may include items such as: a unique identifier to track the call across the CCP's systems, an indicator of whether the call relates to initial margin/variation margin/default fund/rights of assessment/other, a house/client account indicator, underlying unique portfolio/account identifiers, details of any offsets netted against other payments (such as other margin calls, securities deliveries and receipts or coupon payments), a breakdown of the calculation which sets out the individual elements comprising the total, the forms of eligible collateral or the quantity and forms of eligible excess collateral which may be used to satisfy the call, and details of the deadline(s) for meeting the call.

a. DBG agrees that the proposed practice is effective.
b. Providing information mentioned in points a. to d. helps participants to predict and manage liquidity requirements. CCPs remain in control of the uncovered exposure while providing transparency on processes. The provision of granular reports (d.) facilitates Clearing Members to pass through ITD VM calls to participants efficiently.

c. In case the information listed in points a. to d. is not yet provided, implementation efforts may be substantial. Sufficient lead times before implementing such principles should be considered.
d. No comment

3.7 Practice 7

Seeking feedback on the CCP's VM practices from its participants and other relevant stakeholders (e.g., through risk committees or other established mechanisms) in order to aid the CCP's assessment of the trade-off between managing its own risks and the interests of its participants.

a. DBG agrees that the proposed practice is effective.
b. Especially after times of volatile markets, CCPs may benefit from seeking feedback on their ITD handling. The information whether timelines, thresholds and rules are appropriate helps CCPs to finetune their processes to serve both a robust CCP risk management and the interest of the CCP's participants. As some potential VM practices are ruling out one another, seeking feedback provides valuable information on the preferences of the market. It addresses participants' needs or reveals shortcomings on participants' side too. When it comes to the collection or collateralisation of ITD VM, there are not many alternatives though. Uncovered exposure in form of VM losses must not pile up at CCPs to ensure functioning markets.
c. No comment
d. No comment

3.8 Practice 8

Providing transparency to clients regarding the CM's processes and timing of ITD VM calls, which may facilitate clients' ability to predict and manage liquidity requirements. This could be achieved by clearly defining and making available to clients details of the following aspects of the VM calls it issues:

a. its practices and procedures for the calculation and collection/payout of VM;
b. schedules for timely payment that its clients may be required to meet; and
c. its rules and practices concerning:
    i.) the usage and forms of excess collateral eligible for meeting VM calls;
    ii.) acceptance and transformation of non-cash collateral for the purposes of meeting VM calls; and
    iii.) netting arrangements across client accounts.

a. DBG agrees that the proposed practice is effective.
b. No comment
c. No comment
d. No comment