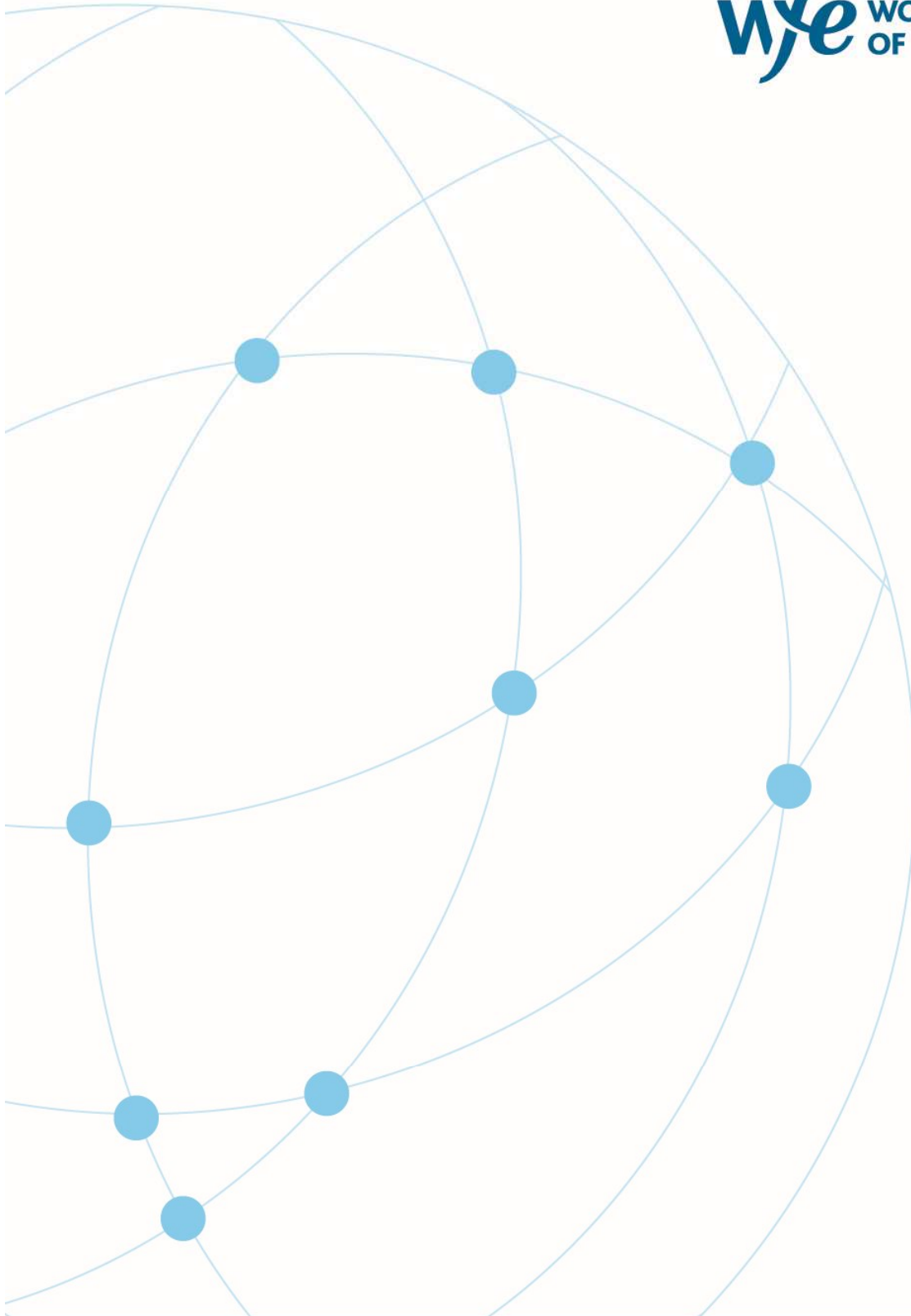




**WFE Response: CPMI-IOSCO report on Streamlining variation
margin in centrally cleared markets
16 April 2024**

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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Response

The WFE welcomes the opportunity to respond to the consultative report on Streamlining variation margin in centrally cleared markets published by the Committee on Payments and Market Infrastructures (CPMI) and the Board of the International Organization of Securities Commissions (IOSCO).

The WFE and its members share regulatory authorities' goals of ensuring the safety and soundness of the global financial system, which is critical to enhancing investor and consumer confidence, and promoting economic growth. CCPs play a crucial role in this regard, as highlighted by the original "Review of Margining Practices" published by the standard setters in 2022, which showed that CCPs are not the cause of undue liquidity pressures in the market, and instead, mute the impact on market stakeholders effectively.¹

A significant factor in this is the role that the exchange of Variation Margin (VM) plays in supporting financial stability, and thus the WFE supports the standard setters' efforts to foster market participant preparedness for VM calls. We also commend the diligent and thoughtful approach taken in crafting a comprehensive set of effective practices as the cornerstone of the consultation which recognises the effective practices set out in the Principles for Financial Market Infrastructures (PFMI) rather than setting out additional prescriptive proposals which may lead to unintended consequences. In particular, the PFMI recognise the importance of CCPs facilitating the exchange of VM, while also considering the liquidity planning needs of participants, where appropriate. The WFE agrees with the consultation's recognition that predictability of VM practices is critical to supporting the liquidity planning of participants, but that this must be balanced against CCPs appropriately addressing the current exposures of their participants.

The WFE note the evidence from the survey suggesting that some CCPs may not be fully implementing the existing guidance related to VM practices and recognises the importance of CCPs upholding the PFMI as implemented by the local regulations to which they are subject.

Overarching Questions

- **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?**

Yes, the WFE generally agrees that effective practices identified in this consultation foster market participants' preparedness for VM calls in centrally cleared markets. However, the WFE also agrees that universal adoption of these proposals, such as VM pass-through, is unlikely due to the multitude of factors outlined above. Additionally, as the consultation recognises, it is of the utmost importance that it is also clear that CCPs must maintain the authority to make unscheduled intraday calls in accordance with its rules and procedures and the PFMI.

- **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.**

There are no other effective practices, mechanisms, or changes to streamline VM processes which the WFE wish to recommend at this time.

Effective Practices

¹ *Review of Margining Practices*, BCBS-CPMI-IOSCO, September, 2022. The review outlined that initial margin (IM) models appropriately addressed the prevailing market conditions during March 2020 and were sufficiently anti-procyclical. Initial margin required by CCPs increased by approximately 40%, compared to the 400% increase in the VIX volatility index, and that even at their peak total (ie VM and IM), margin calls in the centrally and non-centrally cleared space accounted for 2.5% or less of the overall liquidity resources and an average of 5% or less of the central bank reserves held by larger intermediaries. These ratios demonstrate that margin calls had a very small impact on liquidity, were not procyclical, and did not have a destabilising effect on market stakeholders.

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.*

- **Do you agree that it is an effective practice?**

Yes, the WFE agrees that increasing the predictability of ITD margin calculations and collections is an effective practice. The appropriate number of scheduled ITD calls, if any, is highly dependent on the unique characteristics of a CCP's offering, including the risk characteristics of the markets the CCP clears. Therefore, CCPs must retain flexibility in determining in the appropriate number of scheduled ITD calls, if any.

- **What are the pros and cons (including unintended consequences) of the effective practice?**

The WFE agrees in general with the consultation's position that call predictability is important, however, it is also important that CCPs retain flexibility and have the ability to conduct ad-hoc calls, when necessary.

- **Please discuss any drawbacks or hurdles to implementing the effective practice.**

While we do not believe this is the intention of CPMI-IOSCO, it is important that this proposed practice is not misconstrued as calling for CCPs to increase the total number of ITD calls for the sake of increasing them alone. For this proposal to be an effective practice, any increase in the number of ITD calls should be grounded in a clear risk management need and should ultimately provide for further predictability for participants. Increasing the frequency of scheduled ITD margin collections requires significant implementation and operational efforts from market participants and CCPs.

- **Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.**

CCPs may offer a combination of voluntary scheduled collateral runs and event-driven margin calls in the event of significant uncovered exposure exceeding the CCP's thresholds. Increased predictability of ITD margin calculations and collections can also be achieved by regularly providing ITD margin reports, margin changes limited to price and position changes, and communication of thresholds triggering ITD margin calls. In this way, the CCP maintains control over its uncovered exposure while ensuring a high level of predictability of ITD margin calls.

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.*

- **Do you agree that it is an effective practice?**

Yes, the WFE agrees that giving participants sufficient time to manage the liquidity impact of an ITD call is an effective practice, but notes that there are a number of practices a CCP can employ that provide participants sufficient time to manage liquidity impacts of an ITD call, while also providing for a more timely window for participants to meet their calls. For example, the predictability of ITD calls supports participants' liquidity planning, as it allows them to align their liquidity planning with a standardised schedule. As another example, CCPs maintaining an open line of communication with their clearing members and settlement banks to provide advance communication if a clearing member is expected to experience a larger call than typical can also support liquidity planning. Therefore, CCPs must retain flexibility in determining in the appropriate timing for meeting ITD calls.

- **What are the pros and cons (including unintended consequences) of the effective practice?**

A longer notice period can reduce the operational challenges faced by participants (especially those without prearranged and reliable funding arrangements for sourcing liquidity on a timely basis), while shorter notice periods allow CCPs to collect VM more promptly, which can be especially important in times of volatility.

- **Please discuss any drawbacks or hurdles to implementing the effective practice.**

Please see above.

- **Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.**

The survey results highlight that CCPs determine and communicate the methodology around ad hoc ITD call triggers to CMs in advance², but that CMs and end-users do not necessarily process this information. The WFE therefore encourages efforts to facilitate the cascading of this information between CMs and end-users so that they better internalise the full extent of the disclosures provided by CCPs (and in particular, so that end-users are provided with any information provided by the CCP to CMs regarding VM practices).

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

- **Do you agree that it is an effective practice?**

Yes, the WFE agrees that offsetting VM calls against other payment obligations, such as initial margin calls and product payment flows, is an effective practice to reduce liquidity demands on participants, but notes that it may not always be possible or appropriate to do, given the pros and cons of the practices. For example, the ability offset VM calls against other payment obligations is heavily dependent on the denomination of VM obligations and types of collateral accepted. Therefore, CCPs must retain flexibility in determining if VMs call may be offset against other payment obligations.

- **What are the pros and cons (including unintended consequences) of the effective practice?**

Offsetting allows for the reduction of liquidity requirements, but may make it difficult to pass through VM unless, as some CCPs do today, the CCP only accepts cash collateral in the currency of the obligation or only allows for offsets where the clearing member has excess collateral on deposit in the currency of the obligation. Some CCPs may also only offset IM and VM for ITD calls where they do not pass through the VM ITD. However, it should also be noted that once the offsetting of VM calls against other payment obligations is performed, passing through VM profits is not possible without liquidity strains for the CCP. For end-of-day VM calls, CCPs must ensure they are able to pass through VM calls on a fixed schedule per currency, which may require only limited offsetting options.

- **Please discuss any drawbacks or hurdles to implementing the effective practice.**

Please see above.

- **Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.**

No comment.

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.*

² CPMI-IOSCO, Streamlining variation margin in centrally cleared markets, “conditions for ad hoc ITD calls are determined in advance and communicated to members”, pg 15

- **Do you agree that it is an effective practice?**

The WFE wishes to reiterate that "universal adoption of VM pass-through is unlikely", as stated in the consultation. However, in terms of evaluating feasibility and pros and cons, yes, the WFE agrees that it is an effective practice to review operational practices regarding the passing through of ITD calls where CCPs do not employ this practice today. However, given the very specific conditions required to make passing through VM a viable option, the applicability of this practice might be limited.

- **What are the pros and cons (including unintended consequences) of the effective practice?**

Some market participants may appreciate CCPs reviewing their operational practices regarding passing through ITD VM as implementation could reduce their liquidity burden in certain scenarios. Participants who cover their ITD VM losses with non-cash collateral, opposing payment obligations, or a preferred currency could be disadvantaged if CCPs require them to provide cash in the product currency on an intraday basis. Many of these participants would not appreciate being asked to provide potentially illiquid currencies for ITD VM. Because of the lack of robust intraday pricing, only approximations of settlement prices would be available for most products, making ITD-VM settlements questionable.

- **Please discuss any drawbacks or hurdles to implementing the effective practice.**

Any reviews of operational practices in relation to ITD VM pass-through should be proportionate and reflective of changes to the feasibility of implementing pass-through. The implementation of passing through ITD VM increases operational burdens by adding multiple payment runs in various product currencies with multiple settlement schedules. In addition, since alternative collateralisation of ITD VM would no longer be possible, participants would be faced with new restrictions throughout the day.

- **Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.**

Applying Practices 3 and 5 could provide more benefits for both CCPs and participants but limits the applicability of Practice 4. In particular, 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 the maximum extent as long as this does not adversely affect the CCP's investment practices.

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.*

- **Do you agree that it is an effective practice?**

Yes, the WFE agrees that allowing the use of excess collateral to meet ITD VM obligations is an effective practice. Many CCPs permit the use of excess collateral deposited by a CM to meet ITD calls, and many maintain an open dialogue with participants regarding the use of excess collateral, especially in regards to certain days of the year which have a higher volume of transactions (such as triple witching events where stock options, stock index futures, and stock index options contracts all expire on the same trading day, for example).

- **What are the pros and cons (including unintended consequences) of the effective practice?**

Using intraday excess collateral to meet ITD VM obligations can reduce liquidity demands on market participants and the need for ITD margin calls while maintaining CCP control of uncovered exposure. Careful and conservative assessment of appropriate collateral is required as CCPs must be able to convert collateral quickly to efficiently manage default events. When offsetting VM calls against non-cash collateral or cash collateral denominated in a different currency, passing-through VM profits is not possible without liquidity strains for the CCP.

- **Please discuss any drawbacks or hurdles to implementing the effective practice.**

No comment.

- **Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.**

No comment.

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.*

- **Do you agree that it is an effective practice?**

In general, the WFE agrees that providing information regarding the CCP's processes and timing for ITD VM calls is an effective practice in helping participants to predict and manage liquidity requirements. However, it should be noted that CCPs already provide a large amount of disclosures to this respect, including by way of CCP rulebooks and qualitative PFMI disclosures.

- **What are the pros and cons (including unintended consequences) of the effective practice?**

Providing the information outlined above may help market participants predict and manage liquidity requirements. It is essential that CCPs maintain control over uncovered exposure while ensuring transparency of the processes, but in general, aspects such as the detailed reports pointed out in d. could make it easier for CMs to pass through ITD VM calls to participants. However, if thresholds and timings are fully transparent to participants, this may result in adverse participant behaviour and moving around thresholds to maximise capital efficiency, leaving the CCP with uncovered exposure.

- **Please discuss any drawbacks or hurdles to implementing the effective practice.**

Implementation efforts may be substantial where the above information is not yet provided.

- **Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.**

No comment.

7. *Seeking feedback on the CCP's VM practices from its participants and other relevant stakeholders (eg 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.*

- **Do you agree that it is an effective practice?**

Yes, the WFE agrees that participant feedback supports CCPs' assessment of the trade-off between managing its own

risks and the interests of its participants, but CCPs must retain the authority to design their VM practices in a manner that allows them to effectively manage the risks brought by their clearing members. As the consultation and PFMI recognise, it is of the utmost importance that it is clear that CCPs must continue to maintain the authority to make unscheduled intraday calls in accordance with their rules and procedures.

- **What are the pros and cons (including unintended consequences) of the effective practice?**

Particularly after periods of volatility, it can be beneficial for CCPs to obtain feedback on their ITD handling. Information about whether timelines, thresholds, and rules are appropriate helps CCPs to fine-tune their processes to serve both robust CCP risk management and the interests of the market participants. Gathering feedback provides valuable information about market preferences. However, when it comes to the collection or collateralisation of ITD VM, not many alternatives exist. To ensure functioning markets, uncovered exposure in form of VM losses must not accumulate at CCPs.

- **Please discuss any drawbacks or hurdles to implementing the effective practice.**

No comment.

- **Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.**

No comment.

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:*

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

- **Do you agree that it is an effective practice?**

Yes, the WFE agree that providing transparency to clients regarding the CM's processes and timing of ITD VM calls is an effective practice to facilitate clients' ability to predict and manage liquidity requirements. The WFE welcome efforts to increase the level of transparency between CMs and their clients, especially, given that the PFMI is not applicable to CMs and their relationship with their clients.

- **What are the pros and cons (including unintended consequences) of the effective practice?**

No comment.

- **Please discuss any drawbacks or hurdles to implementing the effective practice.**

No comment.

- **Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.**

No comment.