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BCBS Secretariat
Basel Committee on Banking Supervision
Herrengrabenweg 44 Basel
Switzerland
Email: baselcommittee@bis.org

IOSCO Secretariat
International Organization of Securities Commissions
C/ Oquendo 12
28006 Madrid, Spain
Email: margin@iosco.org

Re: BCBS-IOSCO WGMR Report on Streamlining VM Processes and IM Responsiveness of Margin Models in Non-Centrally Cleared Markets (17 January 2024)

The American Council of Life Insurers ("ACLI") appreciates the opportunity to comment on the above-captioned BCBS-IOSCO Consultative Paper ("the Recommendations").[1] The ACLI is the leading trade association driving public policy and advocacy on behalf of the life insurance industry.

Life insurers are significant end-users of derivatives that enable the prudent management of asset and liability risks, as permitted under state insurance codes and regulations.[2] The long-term nature of the industry's life and retirement products requires insurers to match long-term obligations with assets of a longer duration than most other financial institutions, leading to directional portfolios of

[1] BCBS-IOSCO WGMR Report on streamlining VM processes and IM responsiveness of margin models in non-centrally cleared markets (Jan. 17, 2024), *available at:* https://www.bis.org/bcbs/publ/d569.pdf.
[2] The National Association of Insurance Commissioners' (NAIC) Derivatives Instruments Model Regulation:

- Limits derivative transactions to hedging (with limited exceptions) and for prudent uses;
- Requires effectiveness testing to monitor uses over time;
- Requires internal control procedures;
- Establishes counterparty exposure limits and credit quality standards;
- Establishes documentation and trading requirements;
- Archives transparency through statutory reporting (Schedule DB).

long-dated interest rate swaps.[3] Life insurers also use derivatives to hedge annuity products and to manage currency and credit risk.

We strongly encourage coordinated domestic and international approaches to derivatives regulation that will ensure cost-effective, harmonized regulation and prevent regulatory arbitrage.

I. Responses to Questions Posed in Consultative Paper

A. Questions Regarding Streamlining of VM Processes

Q1. Do the resulting recommendations sufficiently address the issues identified in the outreach sessions? If not, what additional recommendations might further address these issues?

Historically, life insurers have been supportive of allowing a range of non-cash collateral types to be eligible for satisfying variation margin ("VM") and initial margin ("IM") requirements.[4] As financial end-users hedging market risks that exist on our balance sheets, being able to post non-cash collateral directly, without the need to employ other liquidity measures such as repos or selling assets for cash, is extremely beneficial to meeting the potential liquidity requirements associated with OTC Derivative positions. We are supportive of the recommendation that firms consider providing flexibility in bilaterally agreed acceptable collateral. We would also be supportive of a structure where new collateral types could potentially be added to the list of eligible collateral types under the WGMR framework and national regulations with appropriate haircuts, particularly to satisfy IM requirements.

After the Global Financial Crisis ("GFC")[5], many regulatory reforms were put in place to reduce counterparty credit risk related to derivatives. These reforms included mandating the central clearing of certain derivative instruments, and the introduction of the uncleared margin rules which standardized VM practices and introduced regulatorily required IM for certain counterparties. These reforms, while mitigating counterparty credit risk, raised the liquidity costs associated with derivative positions. For instruments that are centrally cleared, VM is strictly cash. End-users utilizing these instruments need to hold sufficient cash liquidity to support potential VM requirements in stressed market conditions. Cash-only VM also increases reliance on employing liquidity generating actions, including the potential sale of assets in times of market stress - a procyclical action that may further exaggerate broader financial market distress. Life insurers highlighted the liquidity impacts of mandating clearing in the U.S. CFTC's rulemaking mandating the clearing of SOFR Swaps.[6] We firmly believe that the liquidity effects of mandating a derivative instrument to be cleared should be explicitly considered in any potential future clearing mandate determinations.

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[3] ACLI Comment Letter to CFTC on Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps to Account for the Transition From LIBOR and Other IBORs to Alternative Reference Rates ("ACLI LIBOR Letter") (June 29, 2022), *available at:* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=65925&SearchText=.

[4] ACLI Comment letter to the Federal Reserve and other federal agencies on Final Margin Rules for Uncleared Swaps Transactions (Sept. 23, 2019), *available at:* https://www.federalreserve.gov/SECRS/2020/March/20200327/R-1682/R-1682_120919_137101_437229501632_1.pdf.

[5] Our reference to the Global Financial Crisis is to the 2008-2009 financial crisis.

[6] ACLI LIBOR Letter, *available at:* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=65925&SearchText=.

We are also supportive of the recommendation to consider utilizing third-party services to improve margin practices. The use of triparty custodians to post and collect regulatory IM has, in many ways, streamlined the operational process of using non-cash collateral to satisfy margin requirements. Triparty custodians can systematically check assets against collateral eligibility requirements agreed to between counterparties. However, we would like to note that custodial services related to IM are concentrated in a relatively small number of providers. This situation creates the potential for operational risk in the industry if a provider experienced systems issues. While individual firms conduct their own risk assessments, there are potential industry level risks that exist due to this concentration.

Q2. What operational or legal challenges may arise in effective implementation of these recommendations?

There are several operational challenges that may arise in effective implementation of these recommendations. We note several changes since the GFC that provide potential challenges with implementation of these recommendations:

- The percentage of transactions requiring collateral has increased meaningfully since the GFC, including both mandatory clearing and uncleared margin rules. These regulatory changes have both direct (collateral process) and indirect (investment process) operational and legal implications.
- As settlement dates have compressed, with an increased need for collateralization, re-hypothecation has become increasingly challenging. Given the interconnectivity of several different markets and firms, it is imperative that all firms have robust processes and systems in place to ensure the timely transfer and return of all collateral. Firms and markets would benefit from areas where processes can be voluntarily standardized, benefiting all participants.
- Regulatory mandates have too often been met with an inefficient supply of stable service providers. Service providers with limited capacity or concentrated activities include Futures Commission Merchant ("FCMs") and third parties providing custodial services. Diminished access to these service providers can lead to lengthy implementation periods, costly backup provisioning, and potential market instability.
- Mandatory stay provisions are both relatively new to most market participants and add similar operational and legal challenges as the implementation of compressed settlement dates do.
- In an event of default, the combined imposition of mandatory stay provisions and initial margin on uncleared derivatives introduce additional complexity and is unchartered territory for many market participants. We are very supportive of a market wide tabletop exercise including end-users, dealers, regulators, custodians, and clearinghouses. To this end, some end-users have been discussing such an exercise with the International Swap Dealers Association ("ISDA"), which has been leading the work around this important topic. This exercise would increase the preparedness of many market participants in the face of a Global Systematically Important Bank ("GSIB") insolvency or other problems.

Q3. Are there additional topics or issues that the BCBS and IOSCO should also consider in the final proposals or recommendations?

National supervisors should periodically consider new types of collateral as acceptable collateral. Further, this consideration should be incorporated into international standard-setting and region-specific rulemaking and done in a way that precludes interjurisdictional differences. As an example, fixed-income ETFs have evolved over the last decade and an argument could be made for the assets' inclusion as eligible collateral for VM and IM; given the liquidity, price transparency, and diversification of fixed-income ETFs. Given that these assets are held in triparty accounts and do not need to be rehypothecated for dealer funding, broader criteria would be appropriate for eligible collateral for initial margin. Another asset class that could be considered for IM inclusion is AAA Collateralized Loan Obligations ("CLOs"). As long as these assets have appropriate haircuts, broader eligible collateral criteria can increase flexibility and reduce the cost of regulations, while still achieving a similar reduction in counterparty and systemic risk.

Banking regulations should ensure that incentives exist for using non-cash collateral. Changes to bank capital and liquidity rules in the last decade have had impacts on collateral pledged by end-users to banks and have increased the costs of pledging non-cash collateral.[7] Exorbitant increases in bank capital will disincentivize prudent hedging activity by market participants. Global banking regulations should be more aligned with the need for non-cash collateral exchanges, thereby incentivizing these types of risk mitigation behaviors.

B. Questions Regarding IM responsiveness of Margin Models

Q4. Do you see any issues related to implementing a semiannual calibration to ISDA SIMM?

We understand the concerns around ensuring that the SIMM is kept current through periodic calibrations. However, frequent calibrations can lead to unexpected shifts in margin calls on short notice, even for a stable portfolio. We believe a semiannual calibration cadence would be supportive to these considerations.

Perhaps more important than the frequency of the calibrations, we urge regulators to maintain an approach to model calibration that is industry-wide and consistent across jurisdictions. As end-users of derivatives, life insurers typically trade with a range of highly rated financial institutions. These counterparties are often located across a range of jurisdictions. The establishment of an industry-wide SIMM and the maintenance of an industry-wide approach to the SIMM monitoring framework is essential for allowing us to calculate and confirm IM calls based on a single model. Most life insurers also rely on third-party vendors to implement SIMM. A common approach to the SIMM is essential for facilitating life insurers' use of the model, given the significant resources that would be necessary if model calibrations differed across jurisdictions or even across our dealer counterparties. Having procyclicality and a robust industry-wide validation/calibration process in the model should be the primary way to remediate shortcomings in the model. While we recognize the need for back testing, it should be a fallback option and not the primary way to address shortcomings in the model.

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[7] For example, changes in banking capital regulations have brought modified required Liquidity Coverage Ratios (LCRs), Supplementary Leverage Ratios (SLRs) and Net Stable Funding Ratios (NSFRs) which creates downstream consequences for non-cash collateral pledged by end-users.

Conclusion

We appreciate the opportunity to raise these important considerations. In summary, our comments highlight the need for flexibility on collateral, emphasize the need for strong market liquidity given present market conditions, and encourage a consistent approach to implementing SIMM.

Best regards,

Madison Ward
Counsel
(202) 624-2057
Madisonward@acli.com