JANUARY 2022

AFG'S RESPONSE

Joint Consultative report on the Review of margining practices

AFG

Ensemble, s'investir pour demain

The AFG federates the asset management industry for 60 years, serving investors and the economy. It is the collective voice of its members, the asset management companies, whether they are entrepreneurs or subsidiaries of banking or insurance groups, French or foreigners. In France, the asset management industry comprises 680 management companies, with €4355 billion under management and 85,000 jobs, including 26,000 jobs in management companies.

The AFG commits to the growth of the asset management industry, brings out solutions that benefit all players in its ecosystem and makes the industry shine and develop in France, Europe and beyond, in the interests of all. The AFG is fully invested to the future.

AFG'S RESPONSE TO THE JOINT REPORT ON THE REVIEW OF MARGINING PRACTICES

QUESTION 1: Does the report accurately describe the key market events of the Covid-related period of stress from February to April 2020 and its effects on the magnitude and frequency of the calculation and payment of margin in centrally and non-centrally cleared markets? If not, in what ways are the descriptions not fully representative of the events? Are there any other important events or effects missing? If so, please provide any information or data that are relevant to the missing events or effects to the extent feasible.

AFG welcomes this opportunity to comment on the review of the margin calls practices during the Covid stress period and appreciate analysis undertaken.

We have limited our answers to the questions most relevant to our membership.

Whilst we broadly share the description of key market events related to the period of stress including numerous observations on effects on margins for centrally and non-centrally cleared derivative instruments, we see areas where the report is not sufficiently granular and therefore certain conclusions and interpretations are not shared by our members:

- At a geographical and jurisdictional level: the report does not make any difference between markets and regulatory/legal frameworks existing in Europe, the US and other major financial centres, whereas those contain considerable differences.
- From a participant perspective: the report refers to "clients" without considering the heterogeneity of this population. When the report refers to "clients' perspective" at paragraph 4.3, we don't see to which category of client this paragraph applies nor on which basis the data and statistics are provided.

From a general perspective, we are deeply concerned that IOSCO seems to concentrate its potential regulatory recommendations towards NBFIs -including mainly but not only regulated asset management companies- almost exclusively while in our view, the core issue lies in the lack of transparency concerning CCPs models.

When referring to clients' perspective at section 4.3, we are wondering which methodology has been used to draw your conclusions and determine the percentages to differentiate them. Clarifications will be welcomed on this point.

When looking at Annex B (p.45) regarding the details of the respondents to that worldwide survey, it seems that only 16 of them were asset managers. In our view and without any further details on those managers, in particular concerning their geographical location, the relevant applicable regulatory framework and the typology of investment strategies (management of highly leveraged hedge funds vs traditional open-ended funds with only limited use of derivatives), it seems that this panel is not significant enough to reflect the positions of our Industry. In consequence, the conclusions drawn on p.30 of the survey- "[there was] a non-negligible portion of respondents who reported non-zero deviations" (indicating that the stressed period did lead to unexpected liquidity needs for a portion of the client community)- cannot be considered as really meaningful.

In addition, we have some doubts regarding the following IOSCO's statement (p. 34): "In some instances, and for some specific sectors (e. g. "money market funds (MMFs)") clients may have had to rely on repo markets and sovereign debt markets to raise cash to meet margin calls, or to replenish liquid buffers following the margin calls in March 2020".

Indeed, margin calls have never been an issue when managing the liquidity of a MMF. What could have been observed is the necessity for some institutional investors to redeem their MMF shares in order to meet surging margin calls affecting their derivative portfolios.

But conversely, we agree with IOSCO (still p. 34) that "larger asset managers reported being able to meet liquidity needs from buffers that they maintain for these purposes."

Similarly, we do not agree with the following statement: "Clients' responses highlighted overall market liquidity as an issue" which is not in line with the observations made by our members on March 2020 events: the issue of market liquidity only occurred on some market segments, particularly on fixed income market segments, at different moments during the stress period.

QUESTION 2: Does the report draw appropriate conclusions from the presented observations and analysis of the various aspects of centrally and non-centrally cleared margin during the 2020 stress period? If not, in what cases do you feel the conclusions are not justified by the included analysis? Are there any areas or specific topics of analysis you consider to be missing? If so, please provide any information or data that are relevant to the extent feasible. Please set out your views across the following sections:

a. The drivers of margin calls during the period of market stress covered by the report.

b. The current level of transparency in margin practices by CCPs and intermediaries.

c. The preparedness of intermediaries and clients for meeting the increased margin calls seen during the period of market stress covered by the report.

d. The relationship between margin demands and other liquidity demands during the period February–April 2020.

We insist on the specificity of our status: we are third-party asset managers, acting in the name of our funds and client portfolios. Our profession did not react in the same way than clearing members or CCPs during this crisis period, as our main concern is focusing on the liquidity of our funds, rather than the market liquidity**.** The report should have made a distinction across the different categories of market participants.

Indeed, it should be reminded that redemption-led liquidity issues that a fund may face is generally much more important than margin calls during stress periods. Moreover, it happens that derivative positions are often initiated for hedging purposes then mechanically generate margin calls in favour of the fund.

Our priority is to enhance the transparency of CCP IM models through the improvement on CCP margin transparency: improved data on margin model disclosures, improved risk management processes to increase the ability of CCPs to receive, consider and react to feedback from market participants.

QUESTION 3: Do you agree with the proposals for further international work regarding good practices, metrics and disclosures concerning procyclicality in CCP IM models? Are there other aspects of CCP IM where additional disclosures should be prioritised for further work?

The AFG does not answer this question.

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QUESTION 4: Does the report identify appropriate aspects of transparency in centrally and non-centrally cleared markets for further international work, including identifying data gaps, enhancing disclosures to clearing members and increasing margin model transparency? a. What specific areas of transparency would be most helpful? What (if any) are the barriers to providing those points of transparency? b. Should any other areas of increased transparency be considered?

We consider that the transparency of centrally cleared market should increase especially during crisis periods i.e. the simulation as well as the margin models implemented by both CCPs and clearing members. To better anticipate liquidity and margin stress, our members need to understand how margin models at CCP react in these circumstances and notably how head-ons will be determined / calculated. As the CCP disclosures lacked detail and were inconsistent across entities, we encourage to audit these disclosures to ensure a better quality and consistency of them.

QUESTION 5: Do you agree with the proposals for further international work to enhance liquidity preparedness in the NBFI sector, including the development of appropriate liquidity metrics and disclosures, analysis of liquidity provision robustness and expanded information sharing between intermediaries and clients? Have the proposals identified all key aspects of NBFI sector liquidity preparedness which should be included?

Our members are concerned that IOSCO focuses its actions and its potential further political recommendations to NBFI sector, to which asset managers belong, rather than concentrate on the lack of transparency of models issued by CCPs, which constitutes the main weakness particularly facing stressed scenarios.

Our members consider that there is no need to improve the liquidity preparedness in the NBFI sector, more specifically the asset managers, as these latter are able to mobilize enough stock or securities to respond to margin calls requirements, even during crisis periods as it was the case during March and April 2020. Our members are not in favour to develop any further metrics and disclosures, analysis of liquidity provision robustness and expanded information sharing between intermediaries, as this would potentially lead to the adoption of more restrictive rules for the buy-side, without this being justified.

Finally, our members remind that existing efficient measures are already in force: *guidelines on liquidity stress testing in Ucits and AIFs* published in July 2020 already apply in Europe as well as guidelines for competent authorities and UCITS Management Companies published in August 2014:*https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2014-0011-01-00_en_0.pdf*

QUESTION 6: Do you agree with the proposals for further international work to evaluate data gaps in regulatory reporting by banks and non-banks? Are there particular data gaps you would identify as being of material importance? If so, please provide any supporting information and data to the extent feasible.

We agree with IOSCO's statement that "data and regulatory requirements on the NBFI sector are much more heterogeneous and sparse than in the banking sector." That said, we do not see any gain in seeking to harmonize the regulatory reporting framework of these two sectors. Indeed, the overall liquidity and risk approach by banks significantly differs from non-banks – especially in the asset management sector. Therefore, we do not understand why IOSCO is considering what additional regulatory disclosures or data points could provide authorities with a more comprehensive picture of NBFI sector preparedness and intermediaries' provision of liquidity to clients. More globally, we do not see the need for new and additional reportings at European level.

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QUESTION 7: Does the report identify appropriate proposals for further international work on streamlining VM processes in centrally and non-centrally cleared markets? Should any other aspects of VM processes be included in this work

Our members support proposals to streamline VM processes in centrally cleared markets and advocate to have aligned rules for CCP VM calculation.

They also support the project to streamline VM processes and militate for an alignment of VM processes in centrally and non-centrally cleared markets to a certain extend. Indeed, our members would not support to copy the terms applicable to the cleared trades such as VM in cash only, intraday, T+0 settlement to the non-cleared trades. Our members are not in favour of moving to an intra-day margin process for cleared trades as they do not have the operational capability to do this.

QUESTION 8: Does the report identify appropriate proposals for further international work on the degree and nature of the responsiveness of CCP IM models to market stress? Should any other aspects of CCP margin models be included in this initiative?

This answer combines both Questions 8 & 9. For us, the responsiveness of CCP IM models is a crucial issue as exposed in the section 4 of the report "transparency of margining practices". It has to be stressed that the main issue lies in cleared markets, where end-users such as asset managers are fully dependent on CCP decisions.

This is why we need more transparency on CCP IM models, in particular to know precisely how those models are built in the context of stress scenarios. This increased transparency will allow us to optimize our preparation and to anticipate ahead the occurrence of such situations.

QUESTION 9: Do you agree with the proposals in the report to evaluate the degree and nature of responsiveness of non-centrally cleared IM models to market stresses, remediation of IM shortfalls and the level of disclosure of non-centrally cleared IM model performance? Should any other aspects of non-centrally cleared IM models be included in this initiative?

Please see our answer to the previous question. Our members consider that the existing SIMM model reacted well during the crisis period and should be remained as such and harmonised for both centrally and non-centrally cleared markets.

QUESTION 10: Are there any other important aspects not covered by the report which should also be prioritised for further international work or policy development?

No other aspect to mention.

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41 rue de la Bienfaisance • 75008 Paris • +33 (0)1 44 94 94 00 ■ 45 rue de Trèves • 1040 Bruxelles • +32 (0)2 486 02 90 ■ www.afg.asso.fr