EACH response to the BCBS-CPMI-IOSCO consultative report ‘Review of margining practices’

January 2022

Introduction

The European Association Clearing Houses (EACH) has represented the interests of Central Counterparties (CCPs) in Europe since 1992. CCPs are financial market infrastructures that significantly contribute to safer, more efficient and transparent global financial markets. EACH currently has 19 Members from 15 different European countries. EACH is registered in the European Union Transparency Register with number 36897011311-96.

EACH appreciates the opportunity to provide feedback to the Basel Committee on Banking Supervision (BCBS), the Committee on Payments and Market Infrastructures (CPMI) and the Board of the International Organization of Securities Commissions (IOSCO) on the consultative report 'Review of margining practices'[1].

[1] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD686.pdf

Questions for Consultation

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.

EACH answer 1

While EACH generally believes that the report summarises the key market events of the COVID-19 stress period accurately for the cleared part of the market, we have some reservations about the uncleared part. The large volumes of data made available by CCPs have contributed to the accuracy of the summary of the cleared space. In contrast, the lack of available data in the uncleared space when compared with the cleared one gives cause for reservations on the accuracy of this summary. As shown in table 1 below, the consultative report includes 42 charts and tables that relate to centrally cleared activity whereas only 6 of them relate to the uncleared space. EACH therefore considers that the analysis of the COVID-19 stress period is very limited on the uncleared space, and that further data is needed to provide an accurate picture that results in robust conclusions. We believe that such data should be available to authorities through for example Trade Repositories.

To ensure that the reader better understands the depth of the analysis of the cleared and uncleared space, we also suggest that the report is divided into two main sections: i) analysis of the impact of key market events of the COVID-19 market stress on the cleared space; ii) analysis of the impact of key market events of the COVID-19 market stress on the uncleared space. This division should allow the reader to better understand the depth of both analysis as well as the potential limitations of the conclusions of the uncleared part.

Table 1 - Number of figures/tables included on the cleared space vs the uncleared space

Number of charts included for the cleared vs uncleared space		
Figure name	**Charts per figure for**	
	Cleared	**Uncleared**
CCP variation margin paid	2	-
Breakdown of variation margin paid	2	-
Centrally cleared variation margin flows of client sectors in selected jurisdictions	2	-
Central counterparty initial margin required	2	-
Total required CCP initial margin	2	-
Base-to-peak total initial margin increase per CCP clearing service	1	-
Average largest N-day increases in initial margin requirements for all reporting counterparty clearing services	3	-
Daily CCP margin calls	2	-

Breakdown of daily margin paid by intermediaries	1	1
Average daily collateral balances related to non-centrally cleared margin requirements		1
Centrally cleared initial margin paid by client sectors in selected jurisdictions (stocks)	2	-
CCP initial margin collateral	4	-
Excess CCP margin	2	-
Factors that affected the size of margin calls paid by intermediaries	1	1
Factors that affected the size of margin calls received by intermediaries	1	1
Evolution of CCP initial margin requirements on static portfolios	3	-
CCP margin models	2	-
CCP's anti-procyclicality tools by asset class	1	-
Asset price volatility	2	-
CCP initial margin exceedances	2	-
Intermediaries understand CCP margining policies and procedures	2	-
Intermediaries experiences during the Covid-19 period	1	1
Demands on intermediaries' liquidity resources from margin	1	1
Increased margin calls	1	-
Total charts/tables:	**42**	**6**

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.

EACH answer 2

Drivers of margin calls during the April/May 2020 COVID-19 Market stress

EACH generally agrees with the drivers behind margin calls described in the consultative report. In a survey circulated amongst EACH members as part of an EACH paper on CCP resilience during the COVID-19 Market Stress[2], CCPs responses showed that the main drivers

[2] https://www.eachccp.eu/wp-content/uploads/2021/06/EACH-Paper-CCP-resilience-during-the-COVID-19-Market-Stress-June-2021.pdf

behind the total margin increases (both IM and VM) are market volatility as well as a combination of market volatility and position change. Similarly, the consultation report also identifies market volatility as one of the primary drivers of margin increases, noting also that model reactions to volatility were responsible for the majority of the peak increase in IM requirements.

On Market Volatility, it should be considered that VaR-based models gradually incorporate new information about increased market volatility which translates into margin increase without any margin model change. It should also be noted that the reaction of CCP margin models to severe market volatility in such a way is a function of its design in line with the aim of CCPs to ensure proper Risk management.

EACH found that secondary drivers were position change and change to the level of price rather than the volatility of price. According to the consultative report, price volatility played a roll albeit a smaller one.

Lastly, the report also correctly notes contextually that differences seen in the size of IM increases across CCPs may have been due to differing CCP model implementation, product features or portfolio composition.

Preparedness of intermediaries and clients for meeting the increased margin calls
Regarding point C of Question 2 about the ability of intermediaries and clients to meet the increased margins calls, when responding to an EACH internal survey as part of an EACH paper on CCP resilience during the COVID-19 Market Stress, no CCPs noted that any issues had been reported by clearing members regarding their ability to pay margins during the COVID-19 market stress.

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?

EACH answer 3

'What-if' Scenarios
The Consultative report makes the case for CCPs providing Clearing Members with a wide-range of 'what-if' scenarios to aid their risk management capabilities. However, EACH believes that European CCPs already provide Clearing Members with a wide range of data with which Clearing Members have visibility of the model. In the cases where Clearing Members have visibility of the model, we respectfully believe there is no need for CCPs to provide these 'what-if' scenarios, as Clearing Members' risk managers can calculate any specific situations themselves with the available data, and tailor them to their specific needs, without limiting themselves to the 'What-if' scenarios eventually provided by the CCP

Intra-day and ad-hoc margin calls
In this report, intermediaries argue that CCP intra-day and ad-hoc margin calls performed during this period were untransparent, calling for an improvement in transparency of CCP margins. EACH Members respectfully contest this as margin calls frameworks used by European CCPs are included in the CCPs' rulebooks which are publicly available on the CCPs' websites for everyone's benefit. We would urge Clearing Members and Clients to become more familiar with rulebooks and remain at their disposal should they require any further clarification about their content.

Identifying good practices for VM collection and distribution by CCPs
Page 15 of the report refers to the act of passing-through VM in the intra-day cycle. EACH would like to emphasise that the concept of obliging CCPs to perform a VM pass-through on an intraday basis should be avoided at all costs, as it would be legally, in addition to operationally, challenging to pass through VM. We note that such a concept was outlined by the ESRB in its report of June 2020 on "Liquidity risks arising from Margin Calls", where in section 4.1 it recommended that CCPs should consider the margin covering realised exposures resulting from market movements on that day and that CCPs should consider collecting and paying this out on the same day. EACH would like to reiterate its appreciation that the ESRB requested CCPs 'to consider' rather than 'to oblige' CCPs. This point has been expanded upon in response to Question 7.

Suggested measures to alleviate the liquidity strain of intra-day margin calls
EACH would like to highlight that whilst CCPs already apply several measures to alleviate the liquidity strain of intra-day margin calls, a more widespread acceptance of such measures would be useful. Such measures include:

- **Increasing the range of non-cash collateral eligibility** (e.g. bank guarantee, other instruments (considering proper but less strict level of liquidity and credit risk)) by using prudent haircuts and also the acceptance of credit lines in the Commodities segments would alleviate non-financial institutions from liquidity strains.
- **Intraday netting** of initial and variation margin;
- **Clearing members** to account for change in volumes in their liquidity stress testing when scheduling intraday margin calls.
- **Further increase awareness** of clearing members about how CCP models work, with the objective of increasing clearing members understanding of how the model reacts to stressed scenarios.
- **Keeping prudent and conservative margin models'** input parameters to keep a buffer both pre and post crisis.
- **New Regulation or guidelines for Clearing Members** on how to prepare for sudden and large-scale margin calls from the CCP.

Anti-procyclicality

EACH would like to highlight that whilst European CCPs' margins were less procyclical during this period, improvements can be made. EACH lists the following as some potential improvements that can be made to APC measures:

- **Recalibration of tools** - CCPs believe that the best way to improve APC tools would be through a recalibration of such tools to ensure margin increases in response to volatility are less extreme in the future.
- **Reconsideration and strengthening of margin floors.**
- **Setting a target for the maximum rate of change** over a defined period of time for a specific volatility scenario.

When addressing the question of reviewing APC tools, it should be considered that it is **difficult to balance APC measures with margins efficiency and the safety of a CCP in periods of high volatility**. Taking that into account, some key elements that a review of APC measures should consider include:

- **Evaluation results** - How should one **interpret evaluation results** concerning the effectiveness of the APC rules (i.e. what is considered as 'effective'?).
- **Links to effectiveness of IM models** - To what extent do these rules **interfere with the effectiveness of IM models**, particularly when it comes to EMIR model performance requirements.
- **The scope of application** – It is important to note when should a period be defined as cyclical (e.g. economic downturn or recession) and therefore when should anti-procyclical measures apply. Is it when the majority of instruments is affected? Or even when some instruments that belong to a certain sector are affected (e.g. turmoil in energy stocks)? Or even when issuer specific events lead to a sharp increase of volatility and hence in margin requirements?
- **Outcome based approach** – European CCPs could be compelled to regularly disclose certain procyclicality Key Performance Indicators under an outcome-based approach to APC. This in turn would allow for increased understanding of market participants and regulators and could inform further regulatory adaptations if and as required.[3]

[3] Murphy, D., Vasios, M. and Vause, N., 2016. *A comparative analysis of tools to limit the procyclicality of initial margin requirements. Working* Paper No. 597. [online] London: Bank of England. Available at: https://www.bankofengland.co.uk/working-paper/2016/a-comparative-analysis-of-tools-to-limit-the-procyclicality-of-initial-margin-requirements

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?

EACH answer 4

Current level of transparency in centrally cleared markets

This report makes several proposals to increase transparency in central clearing. However, it should be noted that CCPs currently already use a number of channels through which they provide various means of transparency to Clearing Members which are:

- **Quarterly Public Quantitative Disclosures (PQDs)** – These disclosures made available by CCPs include close to two hundred fields of quantitative data related to the parameters like credit risk, collateral, margin, liquidity risk, default rules and procedures, etc. This disclosure aims to further increase the transparency of financial markets and of CCPs in particular, providing a better understanding of the way CCPs manage risks in financial transactions and deliver efficiency gains. Links are available on the EACH website.
- **Due diligence questionnaires** provided to Clearing Members.
- **One-on-one interactions** between CCP and Clearing Members to answer specific questions.
- **Communication via Risk Council/Advisory Group** meetings between CCPs and Clearing Members.

The report also suggests looking at **more sophisticated tools/simulators for CCPs**, however European CCPs already provide sophisticated Margin simulators that are available for use by Clearing Members. Crucially, EMIR REFIT has included provisions in Article 38 to ensure that all EU CCPs make such a simulator available.[4] Whilst CCPs do provide such sophisticated simulators for Clearing Members and that these simulators allow for scenario planning, it is obviously not possible for CCPs to fully anticipate market moves for its Clearing Members and Clients. They should duly consider this in their risk models.

This report highlights the high level of IM calls in the cleared space in contrast to the more conservative levels observed in the uncleared space. We would like to stress that in the cleared space IM calls saw only a 40% increase over this period, whereas VM calls increased by 460%.

Building on this, EACH believes it is important to increase the awareness of Clearing Members about how CCP margin models work (e.g. how does the model work and react). Given the

[4] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0834&from=EN

already available transparency methods, such awareness would prove more fruitful than making more data available.

Additionally, it would be beneficial to gain increased visibility and understanding on the practices of Clearing Members around data transmission to Clients (i.e. what happens with data once it has been transmitted from a CCP to a Clearing member).

Lastly, EACH agrees with the consultative report's comment that the role which clearing members can play to facilitate transparency for their clients should also be considered. In line with this, EACH would encourage the creation of a Public Quantitative Disclosures requirement for Clearing Members and Clients to further facilitate transparency in financial markets.

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?

EACH answer 7

As mentioned in the answer to Question 3, EACH believes the concept of a VM pass-through should be avoided at all costs, as it would be legally, in addition to operationally, challenging to pass through VM. The market's legal, risk, technical and operational configurations would have to be redrafted. Doing so would un-net intraday payments with the associated risk and operational burden. Table 1 below analyses the issues that EACH finds with this proposal from different angles.

Table 2 – EACH Concerns with VM pass-through

EACH concerns with a VM pass-through	
Legal	EACH believes it would be legally, in addition to technically, challenging to pass through VM as suggested by the ESRB in section 4.1 of their report. The market's legal, risk, technical and operational configurations would have to be redrafted. This challenge becomes explicit in some jurisdictions like the US, where Designated Clearing Organisation (DCO) cannot pass through customer property (client margin) unless it is settlement proceeds (i.e. it is the result of settle-to-market or STM – which occurs once per day). All cleared customer OTC trades in the US have been STM since 2017. Under EMIR, protection of variation margin is not as clearly defined as in US regulation (CFTC LSOC regulation). In particular, as established by Article 39 and 48, protection is for assets and positions. However, as pointed out by ESMA previously, there were some legal uncertainties whether variation margin would fall outside this protection or not (See ESMA report). This reinforces the legal challenge that applying the pass-through approach as proposed in the ESRB document would represent.

Increased Risk	Where loss makers cannot post excess non-cash collateral today to mitigate against intra-day calls in an intra-day RVM process and may actually prove a liquidity burden upon the market. Increased usage of markets by members to transform collateral to meet calls, in some cases at times when liquidity is thinner. Members being paid profits may find difficulties investing appropriately, the later in the day intra-day payments are made; this is likely more relevant for smaller members. CCP's would be required to retain sufficient cash on hand in order to meet payment obligations should member(s) called fail to meet these. This could lead to greater amounts of cash being left unsecured intra-day by CCPs and/or attempts to access transformation markets in order to fund payments during illiquid periods of the day (if not already past cut-off times). In BAU, i.e. without non-receipt from loss makers, these funds then need to be invested later in the day, potentially when liquidity in secured markets is thinner or unavailable.
Operational	This approach could require multiple Realised Variation Margin (RVM) runs intra-day with associated controls around market pricing – it may not always be possible to design the pricing controls as robustly as at end of day and if this process creates actual P&L this could create unexpected market behaviours. Could potentially lead to operational implications for members with flows both in and out on the same day, particularly if underlying clients demand the benefit of profits paid. When considering the USD swap market, CCPs would need to move to a twice daily Settle-to-market (STM) in order to 'settle' and pass through the USD settlement proceeds. If one follows that thinking through, would STM now mean e.g. half a day PnL? Does this means that CCOs should keep e.g. EUR swaps on daily STM (full day PnL)? This becomes overly complex.
Costs	It will create additional transaction costs due to increased flows through settlement banks. There could also be an increase in daylight liquidity lines required, potentially used later in the day, increasing costs for the market.
Accounting	Consideration would need to be given to accounting implications and whether the revised approach would impact mark to market/settle to market frameworks in any way.
Market structure	Not all markets are RVM based and therefor make it less likely that a full net flat liquidity outcome could be supported. This could distort liquidity benefit, with gains paid being subject to some pro-rating, or leave CCP with liquidity shortfall upon payment out.
Current practice	Some CCPs do provide at least one fixed point of the day (in addition to EOD) to pay members excess collateral, based on an approximate MtoM process rather than a full RVM process at a time when investment facilities are still available and controlled through withdrawal limits.

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?

EACH answer 8

EACH would like to acknowledge and support several points made in this report, namely:

- The diversity of model choices for CCPs, which in turn varies depending on asset classes.
- The thorough description of the variety of APC tools available and used by CCPs, varying by CCP.
- The variety of factors that affect the size of margin calls.

Given that Clearing Members as banks are stressed-tested by Regulators and in order to increase the level of preparedness of Clearing Members to the responsiveness of CCPs' IM models, EACH suggests that future banks' stress tests cover the stresses on the market, such as the COVID-19 one and how banks respond to them also in their capacity as Clearing Members, expecting reactions from CCPs' margin models.

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?

EACH answer 9

As mentioned in the response to question 1, we argue that the lack of available data in the uncleared space when compared with the cleared gives cause for reservations on the accuracy of this summary, evidenced by the report including 42 charts and tables that relate to centrally cleared activity whereas only 6 of them relate to the uncleared space. EACH therefore considers that further data is needed to provide an accurate picture that results in robust conclusions. CCPs believe an increased quantity of data disclosed by the uncleared space would be extremely beneficial to long-term market stability. We believe that such data should be available to authorities through for example Trade Repositories.

Furthermore, when comparing the ISDA SIMM model versus models applied by Central Counterparties, the report would do well to consider the effect of the ISDA SIMM model being "less reactive to increases in market volatility" in a situation of market stress as was experienced in March/April 2020. Furthermore, where the comparison of the ISDA SIMM and CCP models is concerned, the prior is generally more conservative, although the ISDA SIMM's conservativeness is itself a function of the holding period assumption used in bilateral markets where less liquid and exotic products are traded. In relation to the comparison of the ISDA

SIMM and CCP models, EACH Members would like to stress that from our point of view, the ISDA SIMM model a) hardly changes to market volatility and b) cannot be calibrated on a daily basis.

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?

EACH answer 10

EACH would like to highlight that CCPs' access to Central Banks facilities constitutes a critical key component that should be supported from a policy making perspective in the interest of financial stability and integrity.

Historically there has been an increased regulatory support for the use of central bank money as a settlement asset in systemically important payment and securities systems, including CCPs. The argumentation is that the use of the central banks as settlement institutions minimises the risk of a failure of these institutions and consequently leads to less systemic risk.

A standardized regime for CCP access to central banks would be a good mechanism to promote financial stability because it would promote:

- **Limitation of exposure to insolvency risk of commercial banks** - Firstly, such regime would assist CCPs in limiting their exposure to commercial banks and their potential insolvency. When settlement in central bank money is not available, CCPs commonly rely on commercial banks to function as concentration banks and enable settlement. Even though CCPs take all steps to limit cash settlement risks, from a systemic risk point of view, settling in commercial bank money involves the additional credit exposure to those entities.
- **Better management of investment risk** - Second, it would allow CCPs to more appropriately manage their exposure to investment risk by depositing cash with central bank accounts.
- **Limitation of exposure to settlement risk** - Third, it would limit settlement risk, in particular those related to the inability of CCPs becoming settlement agents in most of the relevant securities settlement systems.
- **Ensuring a level playing field** - If liquidity features are also considered, this would allow a level playing field with no differentiation for entities that have or not have a banking-license

A complete analysis of this matter can be found on EACH's paper on Access to Central Banks by CCPs publicly available on the EACH website[5].

[5] https://www.eachccp.eu/wp-content/uploads/2021/12/EACH-Note-on-CCP-access-to-Central-Banks-deposits-and-liquidity-December-2021.pdf

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