BCBS-CPMI-IOSCO consultative report on transparency and responsiveness of initial margin in centrally cleared markets.

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INTRODUCTION

The London Metal Exchange ("**LME**") is a UK-based Regulated Market for the trading of derivatives based on a variety of underlying metals. The LME is regulated and supervised by the Financial Conduct Authority as a Recognised Investment Exchange ("**RIE**") and a Benchmark Administrator. The LME holds a number of international overseas licences enabling market participants to access its trading facilities remotely.

LME Clear Limited ("**LME Clear**") is the dedicated clearing house for the LME market. Launched in 2014, it was designed and built in consultation with the market to provide cost-efficient, EMIR compliant clearing services, using cutting edge technology. LME Clear holds a number of international overseas licences enabling clearing members to access its clearing facilities remotely.

LME Clear welcomes the opportunity to respond to this *consultative report on transparency and responsiveness of initial margin in centrally cleared markets* and the thoughtful proposals within the report. As a UK CCP supporting global trade in metal, LME Clear recognises the importance of initiatives aimed ensuring appropriate degrees of transparency generally and applying such standards globally.

Our response the specific questions are contained within the following pages, and are summarised below:

- As a general point, LME Clear is very supportive of the policy objective of ensuring *appropriate* transparency across the value chain from CCPs to end-clients – and specifically relating to initial margin levels in changing environments so that users of the market can manage their liquidity.

- However, we caution that transparency for the sake of transparency isn't always useful and the nuances of particular markets and market structures needs to be kept in mind when imposing new expectations.

- LME Clear notes there already exist comprehensive expectations and requirements relating to transparency from CCPs to Clearing Members.

- To further enhance and extend that, it will be important for Clearing Members to play their part in determining what might be useful from their clients' perspective. CCPs generally do not have a direct relationship with the end client, and in many markets Clearing Members are not obliged to pass on margin. Therefore it is difficult for CCPs to know the exact nature of what information might be useful for clients without knowing what bespoke agreements Clearing Members have with their clients.

- Regarding initial margin simulators, it will be important to consider the balance of cost of implementation and operation vs the reliability (and usefulness) of the output. In considering this we would encourage robust discussion with Clearing Members and their clients to understand exactly what would be useful additional information otherwise there is the risk of costly outlay for limited value.

- Finally: we note the importance of ensuring suitable flexibility in emergency situations. CCPs will in the first instance always seek to follow the procedures as set out in their own rulebooks (which have been developed in coordination with Members) to ensure predictability. However, there may be events which go beyond those prescribed in the rulebooks. As such it will be important to retain a degree of discretion to apply expert judgement (within the boundaries of appropriately agreed frameworks and subject to suitable governance).

GENERAL QUESTIONS

Q1: Collectively if adopted would the set of proposals likely result in increased transparency and a mitigation of destabilising changes in margin requirements in centrally cleared markets? Please identify within the set of proposals any which would be particularly beneficial and others which may be less beneficial (e.g.: where the costs may substantially exceed the benefits). Please provide an explanation to your answer.

LME Clear recognises the importance of ensuring *appropriate* transparency through the value chain. We note that there already exists comprehensive expectations and requirements relating to transparency from CCPs to Clearing Members. Whilst a degree of additional transparency might be helpful between Clearing Members and Clients (or from Clearing Members back to CCPs), we caution that the nuances of individual markets and market structures needs to be carefully considered. We also suggest robust dialogue with Clearing Members and Clients to ensure transparency needs are understood and provide additional value relative to the cost of implementation. This would particularly be the case in markets where bespoke arrangements are in place between Clearing Members and clients which aren't necessarily visible to the CCP.

Q2: Are there any aspects of margining practices in centrally cleared markets that have not been adequately covered by the set of proposals and which could positively contribute to achieving the Margin Group's objectives?

LME Clear has no further comments.

Q3: Many of the proposals recommend that a market participant group (eg all CCPs all CMs etc) be required to provide enhanced disclosure or adopt a new practice. Should the principle of proportionality with requirements dependent on participant size or type be used in determining how different firms apply the proposals? If so in what ways? Please specify the proposal(s) in your response.

LME Clear considers that it might be difficult to be apply the principle of proportionality in the context of the current legislation. However, we do consider practical arrangements could be implemented to reduce any reporting burden – for example where products have limited or no volumes.

Q4: Are there cases in the proposals where there could be an effect on bilateral market margining? If so what are the factors or instances that should be taken into consideration to ensure that proposals for cleared markets do not negatively affect dynamics within other markets?

LME Clear has no further comments.

Policy proposal 1&2 – CCP Margin Simulator

Q5a: Are there certain modes of access to CCP simulation tools which are less costly or more effective (e.g., via an API or upon request)?

It will be important for each CCP to determine the tool(s) it can achieve within the boundary of reasonable costs. Given much will depend on how Clearing Members might wish to use any tools provided, it will be important to closely engage with - and get a view from - Clearing Members to ascertain the most appropriate tool(s) to use.

In doing so, LME Clear would caution against running hypothetical scenarios too far into the future as this is unlikely to be of use for market users to understand their general liquidity position. In addition, increasing the number of assumptions would likely make the output less useful to a broad range of participants.

Q5b: Are there any impediments to making simulators available to clients? To what extent could these impediments be mitigated or resolved eg by changing the mode of providing access to tools or how clients request access to tools? Does this depend on the format of CCP tool (eg the use of cloud technology the use of APIs etc)?

CCPs don't tend to have a contractual or direct relationship with clients of Clearing Members. In addition, CCPs may service markets which have a large number of client types that all require something different. As such creating one-size-fits-all requirements will likely be complex and end up not suiting any one user (or set of users) particularly well.

In addition we note that where clients may be given access to margin simulators to calculate CCP margins, this would not provide the full picture, and potentially would lead to a misleading figure as it would not take into account possible changes to margins that Clearing Members might apply, which might change during stress periods and affect the liquidity requirement of clients.

Q5c: Are there any reasons why the proposed historical and hypothetical scenarios to be provided as part of the simulator tool suite should differ from the CCP's current set of extreme but plausible stress test scenarios? In addition would there be additional value in allowing users to customise their own scenarios within the simulator tool? If so what types of customisation would be of most value?

CCPs such as LME Clear have stress scenarios running into the hundreds in number. As noted in Q5a, we would caution on the usefulness of including scenarios trying to predict outcomes too far into the future as this will lead to the CCP making assumptions that may be misleading. In addition we would caution on providing all internal CCP stress scenarios due to the large number and likelihood that many will not be relevant to Clearing Members or Clients for managing their own liquidity needs. Rather, we think a smaller subset of more generalised extreme but plausible scenarios across a group of products would be more useable and provide market participants the ability to plan based on their own portfolio.

LME Clear expects it would be complicated to build functionality that would enable users to add in their own scenarios. It might be preferable to ask CCPs to work with Member firms to identify specific scenarios that stress portfolios from a liquidity perspective.

5d: Are there any elements of the initial margin calculation (eg add ons) which would be difficult to incorporate into a standardised simulation tool? If so, what are the relevant challenges?

In general we consider some add-ons could be difficult to incorporate into a simulation tool. Certain add-ons will be reliant on other users' portfolios and CCPs having access to information on other Clearing Members which will result in a wide range of assumptions being required. These assumptions may extend into other parameters such as volume assumptions which will again lead to less forecasting accuracy.

Policy proposal 3 – Margin Model Documentation

Where legally permissible, CCPs should make margin model documentation available to CMs at a level that can enable them to understand key aspects of the CCP's margin model and its approach to risk management. This documentation should include the following:

a. **Explanations of the calibration of key model parameters, including any relevant components which affect the size and speed of margin requirement changes during periods of elevated stress.**
b. **The logic, applicable thresholds and data used for the calculation of margin add-ons.**

LME Clear considers there already exists comprehensive and sufficient public disclosure around margin model documentation. We do not feel the benefits would outweigh the costs of providing additional information publicly.

Policy proposal 4 – Disclosing Anti-Procyclicality ("APC") Tools

APC: CCPs should publicly disclose and describe the anti-procyclicality (APC) tools used in their model. CCPs should also publicly disclose and describe, at a high level, the model components that affect the level of model responsiveness.

LME Clear considers there already exists comprehensive and sufficient information relating to APC tools. We do not feel the benefits would outweigh the costs of providing additional information publicly.

Policy proposal 5 – Public Quantitative Disclosures (“PDQs”)

Q6a: With reference to Table 5 (above) would the proposed additional data breakdowns and increased frequency of reporting facilitate market participants’ understanding of the margin system?

LME Clear considers that the frequency and granularity of PQDs at present are appropriate. Providing more frequent or granular information may increase risks – for example users being overwhelmed with information that does not really assist in ensuring liquidity preparedness (given it is backward looking and not at the portfolio level) - or a risk of misinterpretation leading to unusual market reaction or behaviours. Increasing scope and frequency would also introduce additional operational challenges to the CCP. As such it is not clear to us that the benefits would outweigh these additional risks.

Q6b: Would there be any challenges in providing the additional data breakdowns or higher reporting frequencies? If so are there alternatives that would be equally effective? For instance, are there alternative modes of more frequent public disclosures that would achieve a similar goal but result in reduced burdens on CCPs?

As noted in our response to Q6a, LME Clear considers additional data or increased frequency would be unlikely to meet a robust cost benefit analysis.

Q6c: Are there any additional amendments to the PQDs, beyond those set out in Table 5, that would help market participants and stakeholders understand or anticipate changes in margin requirements? What would this information be, and how could this information be effectively incorporated into the PQD framework? For instance, would there be value in including additional non quantitative information in the PQDs related to margin changes?

LME Clear considers any publication of margin-related data should be retrospective on a quarterly basis.

Q6d: Are there any examples of current public disclosures by one or more CCPs which could be used as a guide for improved transparency?

LME Clear has no further comments.

Policy proposal 6 – Margin Responsiveness

Q7a: **Is the proposed method for measuring margin responsiveness (i.e. a large call metric) alongside the associated change in volatility an informative way of measuring responsiveness? If not what alternative approach or methodology should be used and why would that alternate approach better aid market participants in their liquidity planning?**

It is not clear to us that the proposed method for measuring margin responsiveness alongside the associated change in volatility would be an informative way of measuring responsiveness for a variety of reasons including requiring additional assumptions (adding complexity) and not capturing the drivers of margin pro-cyclicality.

As an alternative, we think a metric should rather focus on analysing how initial margin would change under different market stress scenarios, including past periods of volatility.

Q7b: For each parameter input for the responsiveness and volatility risk metrics, please select your preferred choice from the list below or provide an alternative option. Please provide an explanation and any supporting evidence for your choice.

- i. **Large call window: five or 20 days. BCBS-CPMI-IOSCO – Transparency and responsiveness of initial margin in centrally cleared markets 5**
- ii. **Observation period: one quarter or one year.**
- iii. **Product vs portfolio reporting: Product, static portfolio or dynamic portfolio. If supporting product-level reporting, please provide information on which products should be reported by the CCPs. If supporting static and/or dynamic portfolio reporting, please provide information on how the portfolios should be determined and an explanation for how that one portfolio would be representative of clearing activity at the CCP.**
- iv. **Volatility risk metric: Standard deviation or VaR (99%).**
- v. **Volatility risk metric lookback period: 90 days or two years?**

As noted in our response to Q7a, we do not consider that the benefits of referencing volatility in the formula would outweigh the potential costs or effects of doing so.

Q7c: Are there other parameters where calibration decisions are necessary for consistent disclosure of either margin responsiveness or market volatility?.

LME Clear has no further comment.

Q7d: **Do you foresee any challenges in the development and use of the proposed metric? For instance are there challenges in applying a harmonised choice of parameter inputs across all CCPs and all products?**

As previously noted, we caution about any “one-size-fits-all” approach. CCPs operate in different ways, servicing different markets with different users who have differing needs. Any approach would need to be sufficiently flexible to reflect regional differences in different legal, regulatory, and operational environments – and bear in mind nuances in market structures.

Policy proposal 7 – Governance Framework

Q8a: Are there other important balancing factors which should be taken into consideration when evaluating the performance of initial margin models?

LME Clear agrees that the most important metrics for assessing and evaluating the performance of initial margin models are margin coverage, margin responsiveness and costs. However, it is important not to oversimplify these measures.

That relationship is complex and will change depending on underlying market conditions as well as long term decisions made by the CCP. Trying to turn those complex relationships into a simple forecasting model would again result in a number of misleading assumptions being generated.

Q8b: What elements of the "trade off" framework would most help regulators to better understand how a CCP balances between important risk management factors? In what ways would this framework be useful in identifying cases where a review of the model by the CCP and/or the authority would be beneficial?

LME Clear considers it should be the responsibility of the individual CCP to find the balance between the three factors within the "trade-off" framework – within risk appetite and regulatory requirements - while maintaining minimum margin coverage standards. We do not think it should be the responsibility of the regulator to make operational decisions. CCPs continually monitor and review their initial margin model – including assurance from the second line of defence and/or external parties - to ensure that minimum margin coverage standards are always met (balanced against margin responsiveness and costs) but that relationship is dynamic and different for each product.

Policy proposal 8 – CCP use of discretionary judgement

Where CCPs make use of discretion (eg expert judgement) to override model margin requirements, CCPs should:

a. **Have in place clear governance procedures defining the triggers for the use of such discretion and undertake ex post reviews where such discretion has been applied. CCPs should clearly articulate and define the instances and areas where such overrides may be warranted (including clear definitions of the key decision-makers/who can perform overrides and the extent to which these adjustments are deemed permissible without, for example, requiring a material model change). It can similarly be important that the CCP establishes clear guidelines as well as processes which enable the CCP to identify and monitor the overridden risk variable or model output.**

b. **Publicly disclose relevant information regarding the scenarios where discretion may be applied and the governance procedures used in the application of such discretion.**

CCPs should proactively share the governance procedures for the application of model overrides in full with relevant authorities.

c. **Publicly disclose, through additions to the PQDs, the aggregate size and duration of manual margin overrides, as compared with unadjusted IM requirements. The disclosure could be supported by a qualitative explanation of the reasons for the override..**

LME Clear notes that CCPs will always try to follow the procedures as set out in their own rulebooks (which have been developed in coordination with Members) to ensure predictability. However, there may be events which go beyond those prescribed in rulebooks or which are not envisaged in exiting stress test scenarios. Therefore we consider it important to retain a degree of discretion to flex arrangements and apply expert judgement (within the boundaries of appropriately agreed frameworks and subject to suitable governance) on occasion – particularly in unforeseen situations.

Policy proposal 9 – Clearing Member to Client Transparency

Q9a: Are there aspects of the proposal that would be particularly valuable for clients and are there aspects of the proposal that would be particularly challenging for CMs to meet?

As noted in our summary section, LME Clear considers it is important that Clearing Members and clients play their part in helping to determine what might be useful from a client perspective. CCPs generally do not have a direct relationship with the end client, and in many markets Clearing Members are not obliged to pass on margin. Therefore it is difficult for CCPs to know the exact nature of what information might be useful for clients without knowing what bespoke agreements Clearing Members have with their clients.

Q9b: Do CMs currently provide any form of simulation tool, in addition to the tools provided by CCPs? For those who currently do not, what is the feasibility of CMs developing such tools? What functionality would be of most use to clients in CM designed simulators?

LME Clear has no further comment.

Q9c: On the proposed quantitative disclosure described in 9e) do you have supportive or alternate views on the information that should be provided and the format in which the information should be disclosed?

LME Clear has no further comment.

Q9d: Do you agree that CMs should adopt an analytical framework for measuring the responsiveness of initial margin requirements for their clients similar in nature to the proposed framework for CCPs described in Proposal 7? If so in what ways might that framework need to differ from that used by CCPs and in what ways might this depend on the type of CM covered?

LME Clear has no further comment.

Q9e: Do you foresee any barriers or challenges to CMs implementing the proposed disclosures such as cost negative effects on risk management or any potential overlap with traditionally proprietary information?

LME Clear has no further comment.

Policy proposal 10 – Clearing Member to CCP transparency

Q10a: Would the information included in the proposed disclosures aid the CCP's own risk management processes? If not is there alternative information which would be useful for CCPs to receive from members?

LME Clear considers the information included in the proposed disclosures might provide a useful set of information that CCPs may use to have a better understanding of individual Clearing Members and the network of connections across them. However, much will depend on what the Clearing Member is willing to provide.

We do however caution against information provision which may be unhelpful or unusable by the CCP. As such we suggest that any additional disclosure towards CCPs should be provided only if a CCP is able to use or act on that information.

Q10b: Is any of the information included in the proposal description either redundant or duplicative of information already available to the CCP and thus of minimal value? Does any of the information included in the proposed disclosures differ by institution type?

LME Clear has no further comment.

Q10c: Would collection of the information impinge upon current legal disclosure frameworks?

LME Clear has no further comment.

Q10d: Do any of the example disclosures potentially overlap with traditionally proprietary information?

LME Clear has no further comment.