BCBS-CPMI-IOSCO CONSULTATION REPORT ON TRANSPARENCY AND RESPONSIVENESS OF INITIAL MARGIN IN CENTRALLY CLEARED MARKETS

LSEG RESPONSE TO THE BCBS-CPMI-IOSCO CONSULTATION REPORT ON TRANSPARENCY AND RESPONSIVENESS OF INITIAL MARGIN IN CENTRALLY CLEARED MARKETS

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Introduction

LSEG (London Stock Exchange Group) is a diversified global financial markets infrastructure and data business, headquartered in London, with significant operations in Europe, North America, and Asia. With extensive experience, deep knowledge and worldwide presence across financial markets, we enable businesses and economies around the world to fund innovation, manage risk and create jobs. At LSEG, we help to drive financial stability, empower economies and enable customers to create sustainable growth through three business divisions: data and analytics, capital markets and post-trade.

LSEG has majority ownership of the multi-asset global central counterparty clearing house ("CCP") operator, LCH Group ("LCH"). LCH has two licensed CCP subsidiaries – LCH Ltd in the UK and LCH S.A. in France. Both are leading multi-asset class and international clearing houses, serving major international exchanges and platforms as well as a range of OTC markets. They clear a broad range of asset classes, including securities, exchange-traded derivatives, commodities, foreign exchange derivatives, interest rate swaps, credit default swaps, Euro and Sterling denominated bonds and repos.

Executive summary

LSEG welcomes the opportunity to respond to BCBS-CPMI-IOSCO consultation report on transparency and responsiveness of initial margin in centrally cleared markets. We would like to make the following key observations:

- We do not believe there is a need for additional transparency in margin practices in centrally cleared markets. CCPs already provide a great deal of information through CPMI disclosures, margin models, credit and stress testing various volume and transaction metrics.
- LCH margin simulators are made available to members and (upon request) clients of the clearing house, enabling the calculation of IM requirements and as appropriate add-ons on a portfolio level. Regarding forward looking scenarios, we believe these will most likely fail to provide an accurate “guess” of the future and can ultimately be unrealistic since past market behaviour is no guarantee of the future.
- We support standardisation where feasible, however, a standardised metric for measuring IM responsiveness can be particularly challenging given the variety of markets CCPs operate in, and individual product characteristics.
- We are supportive of proposals for a CCP to identify and define an analytical and governance framework, appropriate to their business lines and risk profile, for assessing responsiveness within the broader context of margin coverage and cost, with the framework and parameter choices communicated to relevant authorities.
- We support the report’s proposals for a comprehensive set of information that can be provided by CMs to their clients to support a high-level understanding of the credit and liquidity risks across key markets.
- Regarding Public Quantitative Disclosures (PQDs), the existing PQDs already provide sufficient granularity and at an appropriate frequency for market participants to benefit from it. The proposed daily frequency would result in an overflow of information that many market participants would struggle to consume in a meaningful way and be extremely onerous and resource intensive for the CCPs to produce. In a stress scenario the disclosure of a sharp increase in margin daily could trigger a procyclical reaction of the market participants.

Overarching questions

1. **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.**

We do not believe there is a need for additional transparency in margin practices in centrally cleared markets. As such, we do not support proposals 5 and 6. Regarding the current level of transparency in our margin practices and our risk framework more broadly, members currently have access to the following:

a) CPMI IOSCO quantitative & qualitative disclosures.
b) Rulebook regulations.
c) Risk governance structure and terms of reference.
d) Margin model descriptions.
e) Credit stress testing and the likelihood of guarantee fund assessment disclosures.
f) Various volume and transaction metrics.

In addition, and on a regular basis, we provide various white papers explaining CCP topics of interest such as recovery and resolution, portfolio margining and stress testing.

Regarding transparency of our risk modelling, and in addition to the information available through our online simulators on how margin is calculated and called, our Anti-Procyclicality (APC) tools and approach are carefully documented and approved by LCH Risk Committee, with its performance notified to members of the Committee at least annually. Furthermore, the above-mentioned public disclosures, due diligence processes and frequent one-to-one interactions between the CCP and its members provide an additional layer of transparency. In addition, our margin calls are scheduled at set times whether in quiet or stressed markets conditions to provide predictability not only to our members but to their clients as well. We would highlight that, during March 2020 or more recently during the volatile periods in 22/23, we did not have the need to perform any ad-hoc margin calls (although this is permitted by our rulebook). Therefore, we do not believe that additional requirements on transparency to CCP’s margin practice would impact the level of disclosure already provided by LCH.

Nevertheless, we are supportive of proposal 7 in which a CCP should identify and define an analytical and governance framework, appropriate to their business lines and risk profile, for assessing responsiveness within the broader context of margin coverage and cost, with the framework and parameter choices communicated to relevant authorities. As noted in our response to question 8, this is in line with existing recommendations put forward by ESMA in the EU leaving discretion to CCPs to determine the appropriate framework based on its margin model and the markets it serves.

Finally, we support proposal 9 which includes a comprehensive set of information that can be provided by CMs to their clients to support a high-level understanding of the credit and liquidity risks across key markets.

2. **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?**

We do not believe there are any aspects of margining practices in centrally cleared markets that have not been adequately covered.

3. **Many of the proposals recommend that a market participant group (e.g. 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. BCBS-CPMI-IOSCO – Transparency and responsiveness of initial margin in centrally cleared markets.**

Regarding CCP IM modelling and/or APC tools, we believe standardisation is very hard to achieve and might have unintended consequences given the differences in products, markets and participants involved. For example, this would lead to CCPs reacting in the same way to market stress, potentially amplifying any pro-cyclical effects at the international level. In addition, there is no one size fits all model and full standardisation might limit the capacity for CCPs to adapt to emerging risks in this space. Therefore, when it comes to the adoption of new requirements by CCPs, we would support a proportionate, outcome-based approach. Finally, we believe it is important for CCPs to retain discretion in deciding whether additional functionalities should be built in, based on market demands and economic viability.

4. **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?**

We do not believe the proposals could have any negative effects on the bilateral market. We do, however, wish to highlight that disclosures of basic IM and VM figures in the bilateral market could significantly enhance transparency in those markets.

Proposal-specific questions

5. **Proposals 1 and 2 recommend that margin simulation tools be made available by all CCPs to all CMs and clients, with enhanced functionality.**

    a. **Are there certain modes of access to CCP simulation tools which are less costly or more effective?**

Various modes of access to CCP simulation tools exist based on demand, usage patterns, and the accessibility of technological solutions. Each of those modes are highly dependent on members' needs and can incur different costs. At LCH, we provide members and clients (where those clients are identified to LCH) access to our margin simulation tools. Both members and clients who have access to our margin simulators have access to all-margin breakdown of their current portfolio as well as a breakdown of portfolio changes. In addition, SwapClear members and clients also have access to IM sensitivities and IM scenarios which explain the output. This information is available for the current portfolio. Therefore, we don't find that a particular access to LCH's simulation tool is less costly or more effective.

Importantly, we find that the existing comprehensive offering where the simulators mirror the IM calculation & add-ons in the production environment is the most effective mode for both CCPs and market participants. On the contrary, forward-looking calculations will have significant implementation and maintenance costs, without in our view providing meaningful added value or information to users.

b. **Are there any impediments to making simulators available to clients? To what extent could these impediments be mitigated or resolved, e.g. 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)?**

As noted above, clients who are known to LCH have the ability to access margin simulators. We would expect that, provided clients are technically set up to acquire access to the online simulators, there shouldn't be an impediment to make those available.

c. **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?**

If the stressed scenario-based functionality becomes a requirement that CCPs must provide, we don't believe that the historical and hypothetical scenarios provided as part of the simulator tool suite should differ from the CCP's current set of extreme but plausible stress test scenarios. The suite of extreme but plausible scenarios maintained by LCH for each of its clearing services is subject to frequent controls for completeness and sufficiency of coverage as well as for accuracy of representation of relevant extreme historical market moves. The outcomes of these periodic reviews are notified to the Risk Committee.

Regarding members' customisable scenarios, we believe that attempting to simulate forward looking disclosures will most likely fail to provide an accurate "guess" of the future and can ultimately be unrealistic since past market behaviour is no guarantee of the future. As such, the ability for users to customise their own scenarios within the simulator tool is not expected to add significant value. The level of scrutiny LCH stress suites are subject to, would make it unlikely that such scenarios would provide the users with additional meaningful new information on the margin models behaviour.

Therefore, we find such tailored scenarios to have limited benefit to members and their clients, potentially providing a sense of false security.

Importantly, LCH's standards for mitigating and managing models' potential procyclical behaviour ensured low margin increments during times of market stress as we witnessed during Covid. The biggest total margin increase happened between 5 and 11 March 2020, where the actual total margin requirements for members increased by 8.3% (or 3% on a *constant position* basis, i.e. excluding the amount due to position increases). To ensure that individual members do not experience an increase in initial margin of more than 25%, we require our initial margin models to be built to a standard in which no member would experience an increase of more than 25% over the MPOR in the hypothetical future (generated by a re-run of historical events, including previous crises).

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

We do not believe that there are elements of the IM calculation which are difficult to incorporate into a standardised tool. LCH's margin simulation tools already provide simulators for all margin requirements including market participant add-ons.

6. **Proposal 5 recommends a set of changes to the PQDs, further detailed in Table 5 of the report.**

    a. **With reference to Table 5, would the proposed additional data breakdowns and increased frequency of reporting facilitate market participants' understanding of the margin system?**

The existing PQDs already provide sufficient granularity and at an appropriate frequency. The proposed daily frequency would result in an overflow of information that many market participants would struggle to consume in a meaningful way and be extremely onerous and resource intensive for the CCPs to produce. In a stress scenario the disclosure of a sharp increase in margin daily could trigger a procyclical reaction of the market participants.

b. **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?**

We believe that the current frequency is already quite operationally heavy given the amount of data it involves and required controls to ensure integrity of data. Therefore, expanding the scope of existing disclosures or reporting frequencies would make the production of those reports unworkable. Finally, for the Margin add-ons it will be difficult to find a fit all measure for its reporting, unless those are bucketed in general themes, e.g. concentration, market risk etc.

c. **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?**

LCH believes that the level of existing disclosures at current frequency supplies sufficient level of information and that the operational costs of publishing any additional data (qualitative or quantitative) offsets any eventual marginal benefit. Therefore, we do not support a potential expansion of PQDs.

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

7. **Please review the analytical annex detailing the proposed design of a margin responsiveness metric, as described in Proposal 6.**

    a. **Is the proposed method for measuring margin responsiveness (ie 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?

b. **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.**
    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**

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

d. **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?**

We believe that the volatility dimension makes it challenging to define a 'one size fits all' measure and we do not believe that the proposed measure is fit for the purpose of providing an informative way of measuring margin responsiveness. From our understanding of the proposed measure, the underlying rationale for its formulation is to calculate the extent to which Initial Margin reacts to volatility, with two options for the level at which volatility is to be calculated: (i) portfolio level or (ii) risk factor level.

The volatility metric is inherently very difficult to calculate, especially in a standardised way. Depending on the lookback period, weighting scheme for observations and underlying inputs (risk factors or portfolios), the calculation would return highly divergent answers of limited relevance to underlying member concerns.

We would therefore recommend that a standardised measure should focus on the IM level and changes to it only.

8. **Proposal 7 recommends that CCPs identify and define an analytical framework for assessing margin responsiveness within the broader context of margin coverage and cost.**

    a. **Are there other important balancing factors which should be taken into consideration when evaluating the performance of initial margin models?**
    b. **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?**

We support proposal 7 for CCPs to maintain an analytical and governance framework to evaluate the level of margin coverage and cost. We also believe that, in addition to margin coverage and costs, market specificities and market participants profiles should also be considered when looking at factors. It is against this background that we don't believe a universal framework can be successfully implemented across major jurisdictions.

This is in line with the approach ESMA has taken in its latest report on the procyclicality of CCP margin[1] in which it refrained from defining an analytical framework for assessing margin responsiveness but rather left it to the CCP to determine based on its margin model and the markets it serves. CCPs must be able to tailor its analytic and governance framework to the specific features of the margin models it employs and the products it clears.

9. **Proposal 9 recommends a number of enhancements to CM-to-client transparency.**
   a. **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?**
   b. **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?**
   c. **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?**
   d. **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?**

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?

We support proposal 9 for increased transparency from CMs to clients. A greater understanding of how client margins, including add-ons, are calculated and calibrated would enable them to manage their liquidity needs more effectively. In line with our response to question 1, we believe that CCPs already provide sufficient disclosures to enable CMs to provide such additional transparency to their clients. As such, we do not think that there are any aspects of the proposal that would be challenging or overly onerous for CMs to meet.

10. **Please review the list of example CM-to-CCP disclosures provided at the end of Section 4.3.2.**
   a. **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?**
   b. **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?**
   c. **Would collection of the information impinge upon current legal disclosure frameworks?**
   d. **Do any of the example disclosures potentially overlap with traditionally proprietary information?**

[1] ESMA91-1505572268-3217_Final_Report_Review_of_RTS_No_153-2013_with_respect_to_procyclicality_of_CCP_margin.pdf (europa.eu)

We support the proposal for additional transparency from CMs to CCPs through the disclosure of additional metrics. In line with industry views (CCPGlobal) on this topic, we believe this aids CCPs' risk management and supports a high-level understanding of the credit and liquidity risks across key markets. We recommend that the disclosure be made public, enabling clients to access and conduct due diligence on CMs.

Finally, additional information regarding the CMs' credit exposures in the non-centrally cleared markets will be helpful for CCPs to fully understand the risk profile of their CMs. Overall, the increased transparency and disclosures from CMs will facilitate better risk assessment, monitoring, and mitigation within the CCP ecosystem, ultimately contributing to the overall stability and resilience of the financial system.