OSTTRA

The Board of the International Organisation of Securities Commissions (IOSCO)

Submitted via: baselcommittee@bis.org and margin@iosco.org

Subject: IOSCO Consultation Report on Streamlining VM processes and IM responsiveness of margin models in noncentrally cleared markets.

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D569: BCBS-IOSCO Consultation Report on Streamlining VM processes and IM responsiveness of margin models in noncentrally cleared markets.

OSTTRA, 50/50 owned by CME Group and S&P Global, is a leading provider of progressive post-trade solutions for the global OTC markets across interest rate, FX, equity and credit asset classes. It incorporates CME Group's legacy optimisation businesses – Traiana, TriOptima, and Reset – and IHS Markit's legacy MarkitServ business. OSTTRA brings together the people, processes, and networks to solve the market's most pressing problems through innovating, integrating, and optimising the post-trade workflow. The combined force of the product suite ensures a streamlined post-trade ecosystem that helps clients drive even greater efficiencies. As the demands for automation continue to transform the post-trade landscape, OSTTRA is at the forefront of helping market participants build a secure and sustainable market infrastructure.

Headquartered in London, with a substantial global presence, including regulated entities in the UK and Sweden, OSTTRA employs over 1,300 staff in 16 countries.

OSTTRA is the home of:

MarkitServ: Our end-to-end trade processing and workflow solutions connect more than 2,500 counterparties across the global derivatives and FX markets. We process 10 million trades per month and have transaction confirmations of live customer transactions representing $500 trillion in notional outstanding.

Traiana: A network of over 2,000 counterparties, Traiana processes 37 million trades and $22 trillion in notional per month.

TriOptima: We have supported the OTC industry for over 20 years, compressing more than 2 quadrillion gross notional across 28 currencies and connecting 2,000 counterparties to reconcile 34 million trades per month. We are the market leader in counterparty risk optimisation and collateral management.

Reset: Reset provides leading basis risk mitigation services in the derivatives marketplace. We connect 2,500 counterparties, 145 banking groups across 38 countries. The Reset service is provided by TriOptima AB.

As the leading end-to-end post-trade solutions provider, OSTTRA is pleased to provide its comments to the BCBS-IOSCO consultation, D569, on Streamlining VM processes and IM responsiveness of margin models in noncentrally cleared markets (the "Consultation").

We welcome the opportunity to respond to the Consultation and welcome some of its contents, specifically its recognition of the importance of good margining practices in non-centrally cleared markets.

Today OSTTRA, offer market leading Trade Processing services as well as portfolio reconciliation, cashflow affirmation, collateral management, risk calculations (PV, Initial Margin, XVA), multilateral compression, counterparty risk mitigation (rebalancing), and basis risk mitigation for certain non-centrally cleared OTC derivatives. These services help clients efficiently manage the trade lifecycle to meet a broad range of market and regulatory challenges, specifically optimising resources by lowering costs, minimising operational, credit, and basis risk, improving counterparty exposure management, streamline collateral processing and settlement, and reducing systemic risk in their derivatives portfolios.

Executive Summary:

We welcome the Consultation specifically the WGMR's consideration of the insight, resources, and actions by ISDA and its members in response to the BCBS-IOSCO-CPMI Review of Margining Practices (September 2022).

OSTTRA engages with ISDA's Collateral Initiatives work in response to their members' (our customers) goals to reduce collateral management costs and risks by automating and streamlining collateral management, including documentation and onboarding, margin call and settlement, and collateral optimisation.

We understand that ISDA is committed to ensuring the longevity of the ISDA SIMM®, a robust, regulatory compliant and effective global initial margin model. Dialogue with global regulators has resulted in the adoption of a number of enhancements to the SIMM Governance Framework over time.

We have set out our detailed responses to the questions below.

Questions regarding streamlining of VM processes:

Question 1: Do the resulting recommendations sufficiently address the issues identified in the outreach sessions? If not, what additional recommendations might further address these issues?

OSTTRA participated in the outreach sessions in June 2023. During those sessions, similar recommendations to the published report were discussed:

1) Coordinating streamlined legal negotiation and operational workflows;

2) Expanding eligible collateral options within VM CSAs, within WGMR parameters;

3) Using industry suggested operational practices, such as those published and maintained by ISDA, along with automating non-centrally cleared margin processes; and

4) Using, when appropriate, third-party services and/or infrastructure providers with more robust technological offerings and operations.

Coordinating streamlined legal negotiation and operational workflows

First, it is imperative, per regulatory requirements, that all counterparties have their relationships documented with an ISDA Master Agreement, a Credit Support Annex (or other similar document), and the Eligible Collateral Schedule. (ECS)

It is also helpful that the negotiation and maintenance of such documents is well coordinated by those managing collateral operations, legal representatives, and front-office/trading team members. This coordinated approach can be especially useful when there are times of market volatility and liquidity constraints.

Using online negotiation tools and digital output solutions can reduce the costs of legal documentation negotiations, streamline the onboarding process, and improve time to onboarding, along with automating input to relevant systems via digital documentation output.

Expanding eligible collateral options within VM CSAs, within WGMR parameters

Limiting eligible collateral options to just cash or cash and one type of government security may create an operationally efficient business process. It can also streamline pricing with counterparties as rehypothecation is considered at time of trade.

However, in times of market volatility, having such limited options of eligible collateral documented can increase operational risk and liquidity constraints. For example, if a firm can only post cash and their portfolio of non-cash assets must be liquidated, there are transaction costs and steps necessary during a very tight timeframe of margin calls and collateral settlement workflows. Industry participants are encouraged to consider a broad list of eligible collateral and ensure streamlined operational capabilities, expanding beyond cash and/or cash and government securities.

Updating eligible collateral schedules may have a pricing implication to trades, and also will require resources from legal, collateral management operations, and the front office. As mentioned above, coordinating this effort with a streamlined approach will help mitigate the impact to those resources.

It is important to understand and plan for the operational implications to expanding VM CSAs with broadened eligible collateral schedules, such as accelerated settlement for sourcing collateral, and also managing substitutions. ISDA published a white paper in 2023 that may serve useful to firms planning to expand their eligible collateral schedules: Mitigating Eligible Collateral Risks: From Documentation to Operations.

It is important to note that there are jurisdictional differences with VM requirements which can cause challenges for firms managing cross-border relationships. These issues could be mitigated with substituted compliance and/or updates to rules that are out of sync with the majority of jurisdictions that have similar requirements.

Using industry suggested operational practices, such as those published and maintained by ISDA, along with automating non-centrally cleared margin processes.

The process to calculate a margin call, send communication of a margin call, select the appropriate collateral, affirm the choice of collateral, and settle the collateral with the counterparty should not be unique to each and every counterparty, and every counterparty relationship. Each opportunity for uniqueness creates an equal opportunity of friction for both counterparties involved.

ISDA and its members, including OSTTRA, have developed and published, and continue to maintain a series of Collateral Management Suggested Operational Practices (SOPs) and supporting materials that are available to all market participants, not limited to ISDA members:

- OTC Collateral Processes
- Portfolio Reconciliation, Dispute Management and Reporting
- Settlement, Release, and Reporting of Triparty and Third Party Segregated Collateral
- Notice of Exclusive Control and Pledgor Access Notice
- Posting Cash as IM to be Reinvested into a Money Market Fund (MMF)
- ISDA Collateral Asset Definitions

Firms should access these SOPs, compare with their own operating procedures, identify opportunities for improvement, and then develop implementation plans.
Using, when appropriate, third-party services and/or infrastructure providers with more robust technological offerings and operationally robust solutions.

Some firms may have limited resources and capacity to build out robust internal systems and processes, such as collateral management calculations, margin call messaging, collateral optimisation, and portfolio reconciliation.

If that is the case – for one or any of those steps of the collateral management process - those firms should research, analyse, and implement third party services and/or infrastructure providers that provide mutualised solutions and can serve a purpose at a lower expense compared to internally-built options. These services may include, but are not limited to portfolio reconciliation, margin calculation, settlement processing, collateral selection and optimisation, and end-to-end outsourcing.

Question 2: What operational or legal challenges may arise in effective implementation of these recommendations?

Implementing new workflows and operating models may require short-term strains on resources and/or an investment of additional resources. However, firms must develop business cases that justify this investment, including future cost reduction and risk-reducing benefits.

Question 3: Are there additional topics or issues that the BCBS and IOSCO should also consider in the final proposals or recommendations?

BCBS and IOSCO should also consider encouraging the industry to implement data standards, when performing proactive reconciliation to mitigate disputes by using ISDA minimum market standard. In addition, to the standardisation and automation of the margin process, it should be applied for the collateral interest process to ease the burden between counterparties.

The collateral management system should incorporate margin management, collateral valuation, dispute management, automated settlement process and storing the collateral agreement for ease of access and transparency for OTC derivatives, repo, securities lending, and ETD.

Questions regarding IM responsiveness of margin models

Question 4: Do you see any issues related to semi-annual calibration to ISDA SIMM?

OSTTRA, with its customers, worked through an "off cycle recalibration" last year, which reflected elevated interest rate volatility from the end of 2022, we can comment that operationally this was not a significant amount of work for us, but notifying clients and ensuring they were aware of the off-cycle recalibration and the impacts took significant time through engagement efforts. We therefore welcome the more frequent, planned, semi-annual recalibrations which can become standard in both ours and our clients IM processes.

In response to the BCBS-IOSCO-CPMI Review of Margining Practices (September 2022) and dialogue with global regulators, ISDA has committed to transition to a semi-annual calibration cycle which inserts a recalibration of all delta risk weights in between the annual recalibration of all model parameters, guaranteeing two versions of ISDA SIMM® (SIMM) each year.

The new plan will replace the current schedule which supplements an annual calibration cycle with the potential quarterly recalibration of major delta risk weights in product class(es) which have experienced a new stress period and exhibited material shortfalls.

There are three main issues that we have identified with transitioning to the semi-annual calibration. These three issues are linked to the Model validation timeline and its potential impact on the semi-annual calibration timeline.

In subsequent paragraphs, we present the background and drivers for these issues, we summarise the potential impact to the semi-annual cycle timeline and suggest proposals to address these concerns.

<u>Background</u>

The first two concerns we raise with the model validation timeline are directly linked to the following excerpts from the recent update to EU regulation found in the *Compromise text on the EU regulation* for EMIR 3.0 ("Amending Regulations") and relate directly to the three-month period required for validation and approval of a change to an already authorised model. Here are the excerpts:

Amendments to Article 11, paragraph 3 (***emphasis added***):

> *Financial counterparties and non-financial counterparties referred to in Article 10 shall apply for authorisation from their competent authorities before using, or adopting a change to, a model for initial margin calculation with regard to risk management procedures laid down in the first subparagraph. In applying for authorisation, counterparties shall provide their competent authorities, via the central database referred to in Article 17c, with all relevant information regarding the risk management procedures referred to in the first subparagraph.* ***Those competent authorities shall grant or refuse such authorisation*** *within 6 months from the receipt of the application for a new model and* ***within 3 months from the receipt of the application for a change to an already authorised model****.*

Amendments to Article 11, paragraph 12a (***emphasis added***):

> "*12a EBA shall set up a central validation function for the elements and general aspects of pro-forma models, and changes thereto, used or to be used by financial counterparties and non-financial counterparties referred to in Article 10 for the purpose of complying with the requirements set out in paragraph 3. In its role as a central validator, EBA shall validate the general elements and aspects of those models, including their calibration, design and coverage of instruments, assets classes and risk factors.* ***EBA shall grant or refuse such validation*** *within 6 months from the receipt of the application for validation referred to in the fourth subparagraph of paragraph 3 of this Article for a new model and* ***within 3 months***

***from the receipt of the application for a change to an already authorised model**. To facilitate EBA's validation work, developers of those models shall, upon its request, submit to EBA all the necessary information and documentation.*"

The third concern with the model validation timeline is directly linked to the following excerpts from Article 5 of the Final Draft IMMV RTS (***emphasis added***):

***Article 5: Extensions or changes to the initial margin model, which are not material** in accordance with Article 4(2), shall be notified to competent authorities in accordance with the following:*

*(a) extensions or changes falling under Part I, Section 2, or Part II, Section 2, of Annex I **shall be notified at least two months before their planned implementation date**, in accordance with the documentation requirements set out in Article 6(2);*

*(b) by way of derogation from point (a), **changes to the initial margin model that exclusively consist of changes to the calibration of the initial margin model or calibration methodology** as referred to in Part II, Section 2, point 2, of Annex I **shall be notified at least one month before their planned implementation date**, in accordance with the documentation requirements set out in Article 6(2);*

*(c) **all other extensions or changes shall be notified after implementation**, **at least on an annual basis**, in accordance with the documentation requirements set out in Article 6(2).*

In the subsequent sections, we summarise the concerns that stem from these Amending Regulations and Article 5 of the Final Draft IMMV RTS:

Concerns

(1) **The first concern** is centred on if (a) and (b) described below will run concurrently or separately:

(a) The three-month period required by the competent authority to grant or refuse an application for a change to an already authorised model.

(b) The three-month period required by the EBA to grant or refuse the validation for a change to an already authorised model.

Impact of the first concern:

There is industry-wide uncertainty on total run time periods (a) and (b). Here are three possible scenarios that we have inferred based on the uncertainty:

- **Scenario one:** If (a) and (b) run concurrently, then, under the amended regulation, the process for authorisation by the competent authority and for validation by the EBA would take three months in total.

- **Scenario two:** If (a) and (b) have any sort of overlap, then the time taken would be between three months and six months.

- **Scenario three:** If (a) starts only after the completion of (b) or vice versa, then the time taken would be at least six months.

All these scenarios will significantly undermine the intention of the recommendations to have initial margin models that are more responsive to market volatility by adding significant delays to the current timeline for the semi-annual calibration.

OSTTRA notes that the three-month period is 50% longer than any other jurisdiction's notification period for model changes, which do not exceed 60 days.

(2) **The second concern** is the three-month periods for validation and approval will delay the semi-annual calibration timeline.

To simplify the analysis of the impact, we anticipate that the revised IMMV RTS will confirm that these two three-month periods will run concurrently as described under **Scenario one**.

The current plan for the semi-annual calibration cycle comprises two parts:

(a) **The primary calibration cycle:** will involve a full calibration of the SIMM parameters and testing (using the annual industry backtesting exercise). This cycle will take 7.5 months and the first instance is meant to run from 1 January to 16 August 2025, culminating in a new SIMM version that uses historical data up to 31 Dec 2024 for its calibration.

(b) **The secondary calibration cycle:** will involve the calibration of only the main SIMM delta risk weights and testing (using the quarterly monitoring exercise). This cycle will take 7.5 months and the first instance is meant to run from 1 July 2025 to 14 February 2026, culminating in a new SIMM version that uses historical data up to 30 June 2024 to update the calibration of the main delta risk weights.

Impact of second concern: These three-month periods for validation and approval will delay the times in (a) and (b) by one month each, such that:

- The primary calibration cycle will take 8.5 months, with a new SIMM version becoming effective by the 13 Sep 2025, and,

- The secondary calibration will take 8.5 months, with a new SIMM version becoming effective by the 14 Mar 2026.

This one-month delay could potentially undermine the viability of the current plan and would necessitate further discussion on an updated plan that is based on the principle of decoupling calibration from testing such that any SIMM version released that has only changes that are exclusively due to a recalibration will not require testing by firms before it becomes effective.

(3) **The third concern** is requiring notification prior to implementation of changes to an initial margin model that are only due to a recalibration, which is classified as a business-as-usual process, will contravene the BCBS/IOSCO recommendations to improve the responsiveness of initial margin models.

Impact of the third concern: Under an updated plan that is based on the principle of decoupling calibration from testing, not requiring a notification prior to implementation of pure recalibration changes could potentially expedite the semi-annual calibration plan.

<u>Proposals to address the concerns.</u>

To address the three concerns, we have three proposals:

(1) We request that regulators globally agree that a maximum timeline of 60 days will be used to validate and approve changes to the initial margin model. This would mean that the current semi-annual calibration plan would remain viable. If there is

no acceptance or this proposal, the current semi-annual calibration plan will not be viable.

(2) If there is no acceptance of (1), then the regulators should consider an updated timeline that is based on the principle of decoupling pure recalibration changes from testing, such that a new SIMM version that only has changes due to a recalibration is not tested (by firms or by ISDA) prior to its release.

(3) To enhance the viability of proposal (2) to satisfy the recommendation by the BCBS/IOSCO to improve the responsiveness of initial margin models, regulators should not require any notification before the implementation of pure recalibration changes.

OSTTRA alongside ISDA and its members will continue to engage and facilitate proactive engagement with the community of global regulators and SIMM users to achieve a successful transition to the semi-annual calibration cycle.

Question 5: Are there any concerns with introducing additional procyclicality by more frequent recalibration for SIMM?

The current SIMM calibration process has been implemented to satisfy the requirements of the BCBS/IOSCO margin rules for non-centrally cleared derivatives. The SIMM recalibration is performed annually and also on an ad-hoc basis in the unlikely event that there is evidence of new evolving stress conditions that lead to material underperformance of the model.

The application of the calibration methodology defined by the regulations means that the SIMM initial margin is stable and predictable, and its calculation is transparent.

Moving to a semi-annual cycle would mean that the recalibration of SIMM generally goes beyond the requirements of the regulation such that, on a regular basis, there is a recalibration when neither the regulations nor evidence of market volatility suggests there is a need for recalibration.

Given that the SIMM risk weights are mainly driven by the one-year period of stress used in the calibration, and this period generally does not change often, it is still unclear the benefits that the more frequent SIMM recalibration will bring.

What is clear is that firms, including the smaller firms, will expend significant efforts to implement the semi-annual calibration cycle.

Question 6: Are there additional public disclosures you would wish to see to make the non-centrally cleared initial margin model (SIMM) more transparent?

As recognized in the report, SIMM is appropriately transparent. The model and governance documents are public, and other documents relevant to SIMM implementation and use are made available to SIMM users. Documentation for SIMM model, including periodic assessments made available to designated individuals at global authorities with oversight of SIMM use. .

Question 7: Do you have any suggestions not mentioned in the report to increase the IM responsiveness of SIMM to market shocks?

The adoption of the annual recalibration and off-cycle calibration would mean that the requirements of the regulations are satisfied such that the responsiveness of SIMM is already in line with the regulatory expectation.

Moving to a semi-annual calibration cycle goes beyond the requirements of the regulation. To enable the transition to this new state, we request that regulators consider our proposals to enable the transition.

We welcome continued engagement with the regulators and SIMM users that would remove any roadblocks to the transition to the semi-annual calibration cycle, which goes beyond the requirements of the regulations.

We would be happy to discuss our comments with BCBS, IOSCO or any of their members at your convenience. If you have any comments or questions regarding this submission, please feel free to contact us.

Yours faithfully,

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