Response to the BCBS-CPMI-IOSCO – Review of margining practices – Consultative report

In General

We would like to thank the BCBS, CPMI and IOSCO for the extensive work on margin practices and experiences during the Covid-19 market turmoil that started beginning of March 2020. A period which is considered as the most significant test of the resilience of financial markets since 2008. Thank you for the opportunity to respond to the consultative report that represents the undertaken analysis and questions on the findings and recommendations for further analysis.

Please find in the section below our responses to the specific questions, but first we would like to make a general remark about the 'preparedness' of Non-Bank Financial Intermediaries (NBFIs). We strongly feel that we were well prepared for the events that took place in March 2020 and that we had ample liquidity buffers available. In our opinion the risk for many NBFIs is that at times of market stress it becomes more difficult to transform these liquidity buffers into cash, as these buffers are typically invested in money market instruments. The well-functioning of money markets is crucial under these circumstances. We would therefore suggest to investigate, not only the preparedness of NBFIs, but certainly also the dependency of NBFIs on the liquidity in money markets and possibilities to reduce this dependency. We would recommend to also look into measures taken by certain central banks like the facilities provided by the FED and the Bank of Canada

Answers to Questions for Consultation

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.*

The key market events as the magnitude and frequency of the calculation are well described. There is one aspect that is not referred to in the report, being the fact that the end of March was also a quarter end with its own peculiarities. Next to that – anecdotical - at the start of the volatile market circumstances, some market participants prepared themselves for unexpected liquidity needs by taking up prearranged guaranteed lines from their bank counterparties – even though they did not need the liquidity at that point in time. This hoarding behaviour accelerates and enlarges the stress in the market, as market participants feel they have to act quickly. In our experience this behaviour is a direct consequence of the limited and shrinking balance sheet availability at banks to accommodate the liquidity needs of their clients.

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.*

As what is mentioned in the report, we do agree with the perceived scarce liquidity in the repo market during the Covid-19 market turmoil. We also experienced the mentioned price disruption and the lack of counterparties providing liquidity in the market.
The report mentioned that cash deposits were highly used to meet margin requirements. Our liquidity management is based on a daily and monthly liquidity buffer. The buffer is invested in a range of money market instruments with each its different characteristics and we try to build a so called maturity ladder. When liquidity requirements are substantially higher than what is anticipated (based on normal market circumstances), the distribution among instruments will change depending on the speed of the transformation of each instrument and specific market circumstances into cash. This could lead to a higher percentage of cash deposits in the total portfolio as the longer term deposits will take some time before maturity. In volatile markets, the amounts placed in short term cash deposits will increase to be prepared for higher liquidity requirements that have to be met in the short term. Some research could be done in the term of the cash deposits used during the Covid-19 market stress period and what is normal in other periods.
Our liquidity management policy is based on a certain risk attitude regarding how often rebalancing of the total pension fund investment portfolio should be used as a tool to generate the liquidity to meet all liquidity requirements. With this approach we know that in certain instances we have to sell other securities to generate cash. We didn't use rebalancing as a tool to provide liquidity during the Covid-19 market stress period, but we were ready to do so.

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?*

We do agree that additional work can be done regarding good practices, metrics and disclosures concerning procyclicality in CCP IM models, although we didn't experience any issues regarding IM margin calls ourselves. Ideally, we would meet IM in bonds. As we have access to the CCP via a clearing member, the bonds first need to settle with the CM before it is pledged with the CCP. Intraday calls will most probably met by cash, and therefore we have quite some excess IM at the CCP already, for trading but also for unexpected IM calls. We think that some modelling ex ante could help to better predict the IM increase in future volatile markets.

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

We do welcome further transparency, but we would stress that some information regarding for example the total portfolio could be too vulnerable to share to our counterparties.

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

We would support further work into liquidity preparedness, but we would like to stress that a prescribed framework or introducing mandatory liquidity measures/ratios should not be considered as the solution for being better prepared. In this respect we would like to refer to the general remarks above. Market participants in the NBFI sector are not a homogenous group of participants with equal objectives. For example, pension funds have a long term objective to provide stable pensions to their pensioners. For hedging purposes pension funds have a large exposure to (long dated) derivatives that can cause quite substantial liquidity needs in volatile markets. The liquidity of the overall portfolio is measured and monitored and is part of decision making for long term allocation to certain asset categories. Should we have to maintain a pre-described liquidity buffer it should be noticed that 'cash' as an investable instrument doesn't exist which means that the buffer needs to be invested in money market instruments. In case of liquidity requirements these money market instruments must first be liquidated into cash before it can be used to meet the margin requirements. Furthermore, a high mandatory buffer could do harm to the overall long term ambition of the pension funds to provide pension to their pensioners. In our opinion, the mitigation of this so-called transformation risk and the dependency on money markets is at least as important to investigate as the size and composition of any liquidity buffers.

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

We agree with the proposal to evaluate data gaps in regulatory reporting. We believe additional data regarding the repo markets (price, term, number of counterparties, tri-party/bilateral/cleared) would be helpful to better understand the liquidity in the repo market in all kind of market circumstances and periods.

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?*

We would see some additional value in streamlining VM processes in centrally and non-centrally cleared markets, especially around timing of calls and responsiveness to calls in the non-centrally cleared environment. However, it should be taken into account that the centrally cleared world is quite different from the bilateral world looking at the VM collection process by the CCP compared to VM collection between bilateral counterparties. In particular the ability of CCPs to take the VM from an account even without agreement between parties about the amount that has to be met. We don't believe such a model can be introduced in the bilateral market without introduction of any additional instruments to mitigate risks that arise from such model in the bilateral market.

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?*

We believe it is wise to evaluate the pro-cyclicality of CCP IM models, but a form of procyclicality cannot be avoided in IM models, unless the IM will be in all cases too conservative. We don't think it would be helpful to maintain a too conservative IM amount as this also would impact pricing negatively.

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?*

We think that monitoring the responsiveness of non-centrally cleared IM models could be helpful to further increase the robustness of the uncleared derivatives market. Wouldn't it make sense to look into IM models for centrally cleared and non-centrally cleared at the same time?

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

The focus of the undertaken analysis is on margin practices and experiences and therefore it is logical that the findings and recommendations for further work are linked to the margin practices. Linked to this topic is however the well-functioning of the money market as a whole and the nowadays more limited ability of intermediaries (like banks) acting as market makers to provide liquidity to clients. We believe that due to the smaller capacity of intermediaries to play a role as market maker, the ability of intermediaries to absorb high fluctuations in liquidity needs has decreased substantially compared to the past. Additionally, we believe that, amongst others, the smaller role of intermediaries is one of the reasons central banks had to intervene massively at the end of March 2020.
We would recommend to examine the functioning of the money market today, to examine possible constraints of intermediaries to provide liquidity to clients not just for their own funding requirements only and to analyse why the role of market maker has disappeared and whether additional temporary instruments for central banks are necessary to relieve the pressure on money markets in times of stress. Please note that such an central bank facility should not have the objective to bail out individual market participants in liquidity stress, but to accommodate the well-functioning of money markets and to alleviate the forced selling pressure in already stressed market circumstances.