Dear Committees,

As an employee of a large bank active in the uncleared derivatives market, I would like to make some specific comments about your report on margining practices. Please note that this is my personal opinion and does not represent the view of my employer or ISDA.

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?

Any evaluation of non-centrally cleared margin model responsiveness must distinguish between the two primary sources of initial margin:

1. Bilaterally exchanged IM to comply with the rules implemented following BCBS 261 and subsequent updates

2. One-way IM collected by banks from hedge funds and, to a lesser extent, other credit-constrained clients using proprietary models

Bilateral IM must be agreed between counterparties so any model is likely to be agreed between them in order to allow each to agree the other's margin calls. Each firm will want to use the same model with all counterparties, which leads to a network effect where a single model achieves dominance; this is exactly what has happened with the ISDA SIMM model. Any changes to such a common model must therefore be agreed globally, as unilateral action by any firm will not be agreed by their counterparties. On the other hand, banks can unilaterally adjust the proprietary model they use for hedge fund margin without disrupting the wider market.

In terms of priorities, the report highlights more pressing issues to investigate elsewhere, response of non-centrally cleared IM is low priority. The ISDA SIMM model performed well during the crisis: ISDA's quarterly monitoring reports show overall exceedance rates below the 1% rate across the industry throughout 2020, indeed for every quarter since reporting began in 2017. The exceedance rate did increase but remained below 1%, which vindicates the requirement in BCBS 261 and local regulations to include a period of stress in the calibration period for regulatory IM models. The lack of pro-cyclicality demonstrates the outcome I imagine BCBS 261 envisaged.

In terms of SIMM performance during March and April 2020, a 5% exceedance rate for one month corresponds to one exceedance per month for every portfolio. Exceedance rates must be considered over an appropriate horizon (such as a year or more) to draw valid conclusions. After all, a single exceedance causes a weekly exceedance rate of 20%.

In my view the most important area for further evaluation would be the bilateral remediation practices of firms whose portfolios showed material shortfalls.

Yours faithfully,

Scott Cogswell