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International Standard Setters Publish Consultations on Margin

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TO: ICI Members
ICI Global Members
Derivatives Markets Advisory Committee
Equity Markets Advisory Committee
Global Markets and Investing Working Group SUBJECTS: Derivatives
Financial Stability
International/Global
Trading and Markets RE: International Standard Setters Publish Consultations on Margin

On January 16, the Basel Committee on Banking Supervision (BCBS), the Bank for International Settlements' Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) jointly published a consultation report on Transparency and responsiveness of initial margin in centrally cleared markets - review and policy proposals (the Cleared IM Consultation).[1] On January 17, the joint BCBS and IOSCO Working Group on Margin Requirements (WGMR) published a consultation report on Streamlining VM processes and IM responsiveness of margin models in non-centrally cleared markets (the WGMR Consultation).[2] Comments are due on April 16 and April 17, respectively. This memorandum provides an overview of both consultations.

Background

In September 2022, an ad hoc group established by BCBS, CPMI, and IOSCO (the Margin Group) published a Review of margining practices (Phase 1 Margin Report).[3] Part of the Financial Stability Board's (FSB) non-bank financial intermediation (NBFI) work program, the Margin Group's Phase 1 Margin Report presented analysis of margin calls during the volatility of March 2020 in centrally and non-centrally cleared derivatives and securities markets. The Margin Group identified several areas for further policy work (often referred to as Phase 2) including:

1. increasing transparency in centrally cleared markets;
2. enhancing the liquidity preparedness of market participants as well as liquidity disclosures;

3. identifying data gaps in regulatory reporting;
4. streamlining variation margin (VM) in centrally and non-centrally cleared markets;
5. evaluating the responsiveness of centrally cleared initial margin (IM) models to market stresses with a focus on impacts and implications for CCP resources and the wider financial system; and
6. evaluating the responsiveness of non-centrally cleared IM models to market stresses.

The Cleared IM Consultation and the WGMR Consultation present the results of some of this Phase 2 work.

The Cleared IM Consultation provides policy recommendations for transparency and responsiveness of IM in cleared markets that are addressed to CCPs and CMs. If adopted, implementing the Margin Group's proposals for CCPs would require enhancing existing CPMI-IOSCO's resilience guidance[4] and Public Quantitative Disclosures (PQDs),[5] but would not involve revisions to the existing CCP standards.[6] In contrast, there are no existing standards or guidance that specifically address the proposals for CMs. While the Margin Group notes that banks are subject to much broader existing disclosure requirements, the Cleared IM Consultation does not provide a clear path for implementing these proposals.

Regulated funds are clients of CMs and indirect participants in CCPs. By increasing transparency and enhancing the responsiveness of cleared IM, the proposals in the Cleared IM Consultation are intended to improve client preparedness to meet margin calls, including in times of market stress. This consultation does not set forth expectations for clients, such as regulated funds and their investors, but they are among the intended beneficiaries of the proposals.

The WGMR Consultation presents recommendations for streamlining VM processes and IM responsiveness in non-centrally cleared markets that are addressed to firms, including regulated funds, who are subject to the WGMR Framework. The recommendations would not amend the WGMR Framework for margin in non-centrally cleared markets. Rather, the recommendations are intended to encourage individual firms to engage in good market practices.

In addition to the Cleared IM and WGMR Consultations, a consultation with recommendations for streamlining VM in centrally cleared markets is expected from CPMI and IOSCO in the first quarter of 2024. The FSB is also conducting work to develop high-level, cross-sectoral policy proposals on non-bank market participants' liquidity preparedness to meet margin and collateral calls and is expected to publish a consultative report by April 2024.

The Cleared IM Consultation

The Cleared IM Consultation presents ten policy proposals to enhance transparency and responsiveness of IM in centrally cleared markets, particularly during market stress. To develop the proposals, the Margin Group built upon the work conducted in Phase 1, which provided evidence of the drivers of IM calls and assessed the responsiveness of IM models, central counterparties' (CCPs) approaches to anti-procyclicality, and transparency of margining practices. In addition, the Margin Group held virtual outreach sessions with clearing members (CMs) and clients, conducted a survey of CCPs, and held meetings with relevant industry groups.

The Margin Group's proposals primarily seek to aid market participants' and regulators' understanding of margin responsiveness through increased transparency. The enhanced transparency is expected to mitigate the risk that changes in margin requirements in response to market conditions could have destabilizing or disruptive impacts on participants or additional markets through several reinforcing channels. First, market participants should be assisted in preparing for potential liquidity demands arising from margin requirements. Second, regulators and CCP oversight should be better able to understand and assess margin model performance. Third, CCPs and CMs can build, where possible, standardized approaches that include quantitative-based principles and processes for monitoring and managing margin responsiveness.

Overall, the proposals fall into three general categories (i) transparency, (ii) governance and review of margin models, and (iii) CM transparency.

Transparency proposals

The transparency proposals address four topics pertaining to transparency of CCP margin models and requirements:

1. Margin simulators. The proposals set forth an expectation that all CCPs make margin simulation tools available to all CMs and their clients and specify minimum functionality for the tools.
2. Qualitative disclosures to participants. Similarly, the proposals include an expectation that CCPs should make margin model documentation available to CMs at a level to enable understanding of key aspects of the CCP's margin models and its approach to risk management. The proposals further describe the documentation that should be included. In addition, CCPs should publicly disclose and describe their anti-procyclicality tools.
3. PQDs. Recognizing the importance of the PQDs, the Margin Group proposals aim to ensure consistency and accuracy for the data reported and would introduce new data fields to provide greater public transparency regarding margin responsiveness. The proposals also would increase the frequency of reporting and decrease the lag in order to increase the PQDs' effectiveness. In addition, the Joint Margin Group seeks comment on appropriate harmonization and standardization, which was raised in feedback as a third area of improvement.
4. Measuring and publicly disclosing margin responsiveness. To facilitate public retrospective review of margin in response to stress conditions, the Joint Margin Group proposes that CCPs disclose through the PQDs a new standardized measure of margin responsiveness (designed by CPMI-IOSCO) with associated changes in market conditions.

Governance and review of margin model proposals

The proposals pertaining to governance and review of margin models address, at a general level, the governance framework for assessing model performance and taking appropriate action and, at the more specific level, the governance and review framework where CCPs apply discretion. These recommendations aim to improve the oversight and review of margin models by CCP boards and regulators. At the general level, CCPs would be expected to identify an analytical and governance framework, appropriate to their business lines and risk profile, for assessing margin model responsiveness within the broader context of margin coverage and cost. The framework and parameter choices would be communicated to authorities and used to regularly monitor model performance and, where necessary, trigger the review of model parameters.

Where CCPs may apply discretion or expert judgment to override margin model requirements, the CCP would be expected to have clear governance procedures to define the triggers for the use of such discretion and undertake review after such discretion has been applied. CCPs would also be expected to articulate and define the instances and areas where such overrides could be warranted CCPs would be expected to fully disclose this information with regulators, while publicly disclosing relevant information about the scenarios and governance procedures. In addition, the Margin Group is proposing to revise the PQDs to provide for public disclosure of the aggregate size and duration of manual margin overrides, as compared to unadjusted requirements, that could be supported by a qualitative explanation of the rationale for the override.

CM transparency proposals

In addition to addressing transparency regarding CCP margin models, the Margin Group also examines CM-to-client transparency, aiming to ensure that clients have sufficient understanding of their margin requirements. CMs should facilitate client access to CCP-provided margin simulators and, should also provide sufficient transparency to clients regarding the mechanism by which client add-ons are calculated. Clients should receive documentation with detailed descriptions of the calibration of such add-ons and how the triggers or thresholds for use are set. Where appropriate, such understanding should be facilitated by the CMs' own simulators or by private disclosures of margin requirements calculated under different scenarios. When adjusting client margin requirements, CMs should identify and define an analytical framework, appropriate to their business lines and risk profile, for assessing margin responsiveness, alongside other key factors such as counterparty credit risk. Clients should be provided appropriate notice, without a request, when CMs adjust the calibration of client margin add-ons with sufficient transparency when margin requirements are adjusted relative to those set by the CCP. CMs should also disclose to their clients backward-looking information on the maximum, minimum, and average differences between the CM's client margin requirements and the CCP's margin requirements over a defined period of time.

Between CMs and the CCPs, the Margin Group proposes additional metrics for CMs to disclose to the CCPs of which they are a member. These disclosures would seek to address concerns of interconnectedness and the counterparty exposure to which the CCP and other CMs are exposed. These metrics would be provided on a quarterly basis, with a one-or-two-month lag (to be determined based on feedback to the consultation). The Margin Group is also asking, in the consultation, whether these new disclosures would be redundant of existing regulatory reporting requirements so as to avoid redundant information collections.

WGMR Consultation

The WGMR Consultation sets forth recommendations to streamline VM processes and to increase the responsiveness of IM models in non-centrally cleared markets.

VM Recommendations

With regards to VM, the WGMR's goal was to identify ways to foster market participants' preparedness for above-average VM calls through the efficient collection and distribution of VM and by other means. Informed by the findings from the Phase 1 Margin Report, which suggested that VM issues in non-centrally cleared markets were localized, the WGMR Consultation identifies industry practices that could improve and strengthen current VM processes.

More specifically, the WGMR recommends:

1. Regular due diligence. The WGMR encourages firms to address operational and legal challenges that could potentially inhibit the seamless exchange of margin and collateral calls during periods of stress.
2. Increased flexibility on acceptable collateral. The WGMR recommends that firms consider increased flexibility regarding acceptable collateral to mitigate potential liquidity issues and a subsequent 'dash for cash' during market stress.
3. Increased standardization and automation. The WGMR finds that increased standardization and automation of non-centrally cleared margin processes can reduce frictions and the possibility of operational delays or failures.
4. Use and oversight of third-party service providers. The WGMR recommends that firms consider whether using third-party services could improve non-centrally cleared VM processes, while cautioning that the use of such services should be properly risk managed.

IM Recommendations

The WGMR's recommendations for the responsiveness of IM models are built upon new work that investigated the mechanisms to increase the responsiveness of non-centrally cleared IM to a market shock, including a survey of supervisors. The WGMR welcomed the industry's efforts undertaken in response to the Phase 1 Margin Report. Ultimately, the WGMR does not recommend revisions to the WGMR Framework, rather finding that the issues relate to the implementation of the framework. In particular, the WGMR recommendations address:

1. Processes and reporting. As the WGMR looks to improve the implementation of the WGMR Framework, the WGMR recommends that firms have appropriate processes to calculate IM pursuant to the WGMR Framework and conduct periodic backtesting. Firms should provide information to ISDA and supervisors regarding these processes and the results of and actions taken in response to backtesting.
2. Operational preparedness for shortfalls. The WGMR encourages operational preparedness to identify and remediate bilateral margin shortfalls in a timely manner.
3. Off-cycle/semiannual recalibration. The WGMR encourages firms to be more agile in their operational processes and be prepared to incorporate off-cycle and in future semiannual recalibration of risk weights.
4. Liquidity arrangements. The WGMR encourages firms to have liquidity or arrangements to source sufficient liquidity to meet unanticipated IM changes, which may be caused by off-cycle or semiannual recalibration, bilateral shortfalls, or other cause associated with regulatory IM.

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Notes

[1] BCBS-CPMI-IOSCO, Consultative report: Transparency and responsiveness of initial margin in centrally cleared markets - review and policy proposals (January 16, 2024).

[2] BCBS-IOSCO, Streamlining VM processes and IM responsiveness of margin models in non-centrally cleared markets (January 17, 2024).

[3] BCBS-CPMI-IOSCO, Review of margining practices (September 29, 2022).

[4] CPMI-IOSCO, Resilience of central counterparties (CCPs): Further guidance on the PFMI (July 5, 2017).

[5] CPMI-IOSCO, Public quantitative disclosure standards for central counterparties (February 26, 2015). The PQDs set expectations for the minimum public quantitative disclosures expected of CCPs.

[6] CPSS-IOSCO, Principles for Financial Markets Infrastructures (December 14, 2012). The Committee on Payment and Settlement Systems (CPSS) changed its name to the Committee on Payments and Market Infrastructures (CPMI) in September 2014.
