

MEMO# 35629

February 26, 2024

CPMI-IOSCO Publishes Consultation on Effective Practices to Streamline Variation Margin in Cleared Markets

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February 27, 2024

TO: ICI Members

ICI Global Members

Derivatives Markets Advisory Committee

Equity Markets Advisory Committee SUBJECTS: Derivatives

Financial Stability

International/Global

Trading and Markets RE: CPMI-IOSCO Publishes Consultation on Effective Practices to Streamline Variation Margin in Cleared Markets

On February 14, the Bank for International Settlements' Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) published Streamlining variation margin in centrally cleared markets - examples of effective practices (the Consultation).[\[1\]](#) Comments are due on April 14. This memorandum provides an overview of the Consultation.

Background

In September 2022, an ad hoc group established by the Basel Committee on Banking Supervision (BCBS), CPMI, and IOSCO (the Margin Group) published a Review of margining practices (Phase 1 Margin Report).[\[2\]](#) 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 central counterparty (CCP) resources and the wider financial system; and

6. evaluating the responsiveness of non-centrally cleared IM models to market stresses.

On January 16, international standard setters published two related consultations regarding (i) transparency and responsiveness of cleared IM and (ii) streamlining VM and IM responsiveness in non-centrally cleared markets.^[3] Those two consultations and this Consultation present the results of some of the Phase 2 work. In addition, 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 Consultation provides examples of effective VM practices that are addressed to CCPs and their clearing members (CMs), to inform the design of CCP and CM VM practices. The Consultation is presented as proposed guidance that supplements existing standards and guidance.

Regulated funds are clients of CMs and indirect participants in CCPs. The effective practices in the Consultation are intended to improve client preparedness to meet above-average margin calls through the efficient collection and distribution of VM in centrally cleared markets. This Consultation does not set forth expectations for clients, such as regulated funds and their investors, but they are among the intended beneficiaries.

The Consultation

Building on the work from Phase 1 with surveys to CCPs, CMs, and clients, CPMI-IOSCO reached the effective practices in the Consultation. The effective practices cover frequency, timing, and scheduling of intraday VM calls; the pass-through of VM by CCPs and collateral eligibility; and transparency.

CPMI-IOSCO found evidence that suggests some CCPs may not be fully implementing the existing guidance pertaining to VM practices but did not identify specific examples. The effective practices are intended to encourage better implementation of the standards and guidance pertaining to VM processes.

In addition to the effective practices, CPMI-IOSCO notes that an overarching issue is heterogeneity of CCPs' processes, which is particularly acute for intraday VM processes. The lack of alignment arises, at least in part, from regulatory differences. The Consultation notes that there could be significant benefits for liquidity preparedness from aligning CCP's VM practices but does not present solutions to address the issue.

Frequency, timing, and scheduling of intraday VM calls

The Consultation presents practices that address the frequency, scheduling, and timing of intraday VM calls. These practices are intended to improve liquidity preparedness and mitigate liquidity demands in times of stress. CPMI-IOSCO acknowledges that the timing and frequency of VM calls requires CCPs to balance significant interests in tension. Increasing the frequency and predictability of scheduled intraday calls and shortening the time for payment mitigate the build-up of current exposures, particularly during increased volatility. At the same time, intraday calls create liquidity demands for CMs, which can be challenging to meet, particularly since clients do not pay intraday VM to their CMs. Standing liquidity lines may also be under stress. Another challenge is that many CCPs do not net and synchronize payment flows, which reduces liquidity demands on participants.

Pass through of VM and collateral eligibility

The Consultation recognizes that liquidity demands on participants can be mitigated when the CCP both collects and pays out VM in each payment cycle. Another practice that can mitigate liquidity demand is permitting CMs to deposit collateral in excess of margin requirements, including on behalf of clients, and applying such collateral to meet intraday calls.

Despite these generally recognized benefits, many CCPs collect VM during intraday VM cycles but do not pay out VM until the end of the day. A significant restraint is CCP's avoidance of intraday collateral transformation. With VM obligations due to and from the CCP in the currency of the underlying exposure, CCPs would need to engage in collateral transformation if the payment were made to the CCP with another type of collateral. In addition, if CCPs pay out a VM obligation with collateral that is different than the expected currency, receiving CMs could face liquidity mismatch issues.

Considering the significant constraints, CPMI-IOSCO acknowledges that universal pass through of VM is not feasible. Yet, the Consultation encourages CCPs to consider ways to expand the pass through of VM, particularly where payment is made in cash in the same currency as the underlying exposure. The Consultation also encourages CCPs to offer CMs and clients an option for their excess collateral to be used to be netted against VM calls. Notably, CPMI-IOSCO states that CMs and clients, such as regulated funds, should opt in since there may be a preference for this practice to be limited to times of increased volatility rather than business as usual.

Transparency

The Consultation seeks to enhance transparency regarding VM process between stakeholders. It recommends that CCPs provide information to CMs and clients regarding the CCP's processes and timing for intraday VM calls, to facilitate participants' ability to predict and manage liquidity requirements. One way to do so is to provide clear definitions in the CCP's rulebook or other documentation. In addition, CCPs are encouraged to seek feedback on their VM practices from its participants, including regulated funds, and other stakeholders regarding the CCP's VM practices. This would include feedback on the factors that the CCP balances in designing the VM practices, managing the risks of the CCP and the interests of participants.

CPMI-IOSCO similarly encourages CMs to provide their clients with information regarding the VM calls issued to clients, but notes it cannot provide specific guidance for CMs, as that is outside of its mandate.

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Notes

[1] CPMI-IOSCO, [Streamlining variation margin in centrally cleared markets - examples of effective practices](#) (February 14, 2024).

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

[3] BCBS-CPMI-IOSCO, [Consultative report: Transparency and responsiveness of initial margin in centrally cleared markets - review and policy proposals](#) (January 16, 2024); BCBS-IOSCO, [Streamlining VM processes and IM responsiveness of margin models in non-centrally cleared markets](#) (January 17, 2024). ICI's memo summarizing these consultations is available [here](#).

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