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CPMI Secretariat
cpmi@bis.org

IOSCO Secretariat
VMconsultation@iosco.org

Re: *Streamlining variation margin in centrally cleared markets – examples of effective practices*

Dear Secretariats:

ICI Global[1] appreciates the opportunity to provide comments on the Committee on Payments and Market Infrastructures (CPMI) and International Organization of Securities Commissions (IOSCO)'s consultation on streamlining variation margin in centrally cleared markets.[2] Our members, regulated funds[3] in jurisdictions around the world, are key participants in central clearing and use centrally cleared products in a variety of ways to implement their investment strategies.[4] As customers of clearing members (CMs) of registered clearing entities, regulated funds are subject to initial margin (IM) and variation margin (VM) requirements calculated by a central counterparty (CCP). These requirements may be adjusted and are then imposed by a CM, and our members deposit funds and assets as necessary to meet the requirements. To this end, we

[1] ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated investment funds. With total assets of $43.6 trillion, ICI's membership includes mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States (US), and UCITS and similar funds offered to investors in Europe, Asia, and other jurisdictions. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. ICI Global has offices in Brussels, London, and Washington, DC.

[2] CPMI-IOSCO, Streamlining variation margin in centrally cleared markets – examples of effective practices (14 February 2024) (the Consultation).

[3] For purposes of this letter, the term "regulated fund" refers to any fund that is organised, formed, and regulated under national law, and is authorised for public sale. Such funds typically are subject to substantive regulation in areas such as disclosure, form of organisation, custody, minimum capital, valuation, investment restrictions (*e.g.*, leverage, types of investments or "eligible assets," concentration limits and/or diversification standards). Examples of such funds include US investment companies regulated under the Investment Company Act of 1940 and European Union (EU) UCITS.

[4] Derivatives, including those that are centrally cleared, offer regulated funds considerable flexibility in structuring their investment portfolios. These uses include hedging positions, more efficiently deploying cash that a regulated fund cannot immediately invest in direct security holdings, managing a regulated fund's cash position more generally, and adjusting duration.

support many of the recommendations from the Basel Committee on Banking Supervision (BCBS), CPMI, and IOSCO to improve margin practices following the market volatility in March 2020.[5]

Despite the unprecedented market stress during that time, the overwhelming majority of regulated funds, including US-domiciled regulated funds, continued to function normally and redeem shares upon demand.[6] Consistent with their normal operations, regulated funds also continued to meet their margin calls. As BCBS-CPMI-IOSCO concluded, more than 93 percent of clients, including regulated funds, met margin calls on the day they were due, with no significant changes in these figures across February, March, and April 2020.[7] Through robust liquidity risk management programs, internal stress testing, and the flexibility to use a range of liquidity and liability management tools, regulated funds were able to appropriately prepare for and meet redemption requests and ensure that margin calls were fully and timely paid.

Nevertheless, global regulators can improve margin practices in the derivatives and securities markets, accelerating and making margin collection transparent and efficient to alleviate downstream stresses on the broader financial system. We and our members have long supported efforts to enhance the transparency and governance of margin practices which will help regulated funds and other clients better prepare for future market stress events.[8]

We are, however, concerned with the finding in the Consultation that CCPs may not be fully implementing existing guidance related to VM practices[9] and we encourage CPMI-IOSCO to conduct further work to ensure all CCPs fully implement existing guidance.

We are generally supportive of CPMI-IOSCO's work to identify good practices for the collection and distribution of VM. Enhancing and streamlining VM processes, including those surrounding intraday margin calls, would promote the safe and effective operations of those markets. We also express our support for the examples CPMI-IOSCO provides of good practices for CMs.

[5] BCBS-CPMI-IOSCO, Review of margining practices (29 September 2022) (Margin Review); Letter from Jennifer S. Choi to BCBS, CPMI, and IOSCO Secretariats re Consultative Report on Review of Margining Practices (26 January 2022) (ICI Phase 1 Margin Letter).

[6] *See, e.g.*, ICI, Experiences of European Markets, UCITS, and European ETFs During the COVID-19 Crisis (December 2020); ICI, Report of the COVID-19 Market Impact Working Group, The impact of COVID-19 on Economies and Financial Markets (October 2020); ICI, Report of the COVID-19 Market Impact Working Group, Experiences of US Money Market Funds During the COVID-19 Crisis (November 2020).

[7] *See* Margin Review at 32.

[8] *See*, *e.g.,* ICI Phase 1 Margin Letter.

Notably, in their capacity as end-users, individual ICI members have contributed to several industry efforts to develop and offer sensible recommendations toward achieving these objectives, including as members of a key Commodity Futures Trading Commission (CFTC) Market Risk Advisory Committee (MRAC). *See, e.g.,* CFTC MRAC CCP Risk and Governance Subcommittee, Recommendations Regarding CCP Margin Methodologies (12 February 2021). Our members also contributed to a 2020 industry whitepaper that provides specific recommendations from end-users and clearing members to enhance CCPs' resilience. A Path Forward for CCP Resilience, Recovery and Resolution (March 10, 2020) (2020 Industry Whitepaper).

[9] *See* Consultation at 3.

Transparency across all parts of the clearing chain, from the CCP to the end-user is critical, although the potential effectiveness of identifying these good practices may be reduced without also clearly specifying an authority that can ensure consistency across the industry.

Despite the proposals' anticipated benefits, we provide more detailed comments below on the following:

- Increasing the predictability of intraday margin calls through the development of guidance for planned intraday margin calls and to restrict *ad hoc* calls;

- Expanding the types of eligible collateral, based on appropriate risk-based eligibility principles; and

- Mitigating operational risks and liquidity demands through enhanced standardisation of VM processes and disclosures and increased alignment of payment flows.

1. Intraday margin calls must be predictable

We generally support the Consultation's good practices regarding the frequency, timing, and schedule of intraday margin calls. The goal of work in this area should be to increase the transparency and efficiency of margin processes, including through strictly restraining discretion to use *ad hoc* margin calls and acceleration of the exchange of margin. Such changes will assist market participants in actively tracking and monitoring liquidity demands and avoid timing mismatches between intermediaries, so that market participants are not forced to retain additional and unnecessary liquidity buffers, which acts as a drag on performance.

We appreciate that the Consultation aims to increase the predictability of intraday margin calls and collections, which may be achieved by using or increasing the frequency of scheduled intraday calls. Yet, the Consultation focuses on considerations CCPs should balance and refrains from identifying means to measurably achieve this goal.

While we appreciate that the Consultation takes steps to encourage CCPs to decrease reliance on *ad hoc* intraday margin calls, we remain concerned that CCPs have significant discretion to use *ad hoc* margin calls, which are unpredictable and leave clients, including regulated funds, unable to prepare. Indeed, *ad hoc* intraday margin calls are associated with increased operational and liquidity risk. To confront and mitigate these risks, CCPs' discretion to use *ad hoc* margin calls should be strictly restrained.

CPMI-IOSCO can address these concerns with additional guidance to increase the predictability and transparency of intraday margin calls. We recommend this guidance set forth:

- **Specific guidelines for adopting transparent thresholds or timeframes for scheduled intraday calls.** Although there are many factors that CCPs consider in designing margin practices generally, there are limited options for designing predictable and transparent intraday margin calls. They can occur either at preset times throughout the day or when a pre-defined market threshold is met.

- **Pre-defined margin deficit thresholds that must be reached before a CCP may use an *ad hoc* call.** With all CCPs using scheduled calls with pre-defined thresholds, the instances in which there is an excessive buildup of exposures that warrants making an *ad hoc* call would be rare, generally limited to periods of extreme volatility. Additional predictability and transparency can be introduced through guidance.

- **Guidelines to restrict the application of *ad hoc* calls to participants of relevant clearing services.** Given differences among product classes, volatility does not homogenously impact all cleared products. Exposures may therefore not build to excessive levels to all products that a CCP clears and an *ad hoc* intraday margin call may not be needed across all of a given CCP's clearing services. The increased risks associated with *ad hoc* intraday calls can be mitigated by limiting the application of the calls.

2. Collateral eligibility should be expanded

We appreciate the Consultation's consideration of the impacts of expanding collateral eligibility. In the Consultation, CPMI-IOSCO observes that expanding collateral eligibility could reduce intraday liquidity requirements but expresses concerns about the creation of inefficiencies in subsequent intraday and end-of-day margin cycles.

We note that there are significant benefits to expanding the types of eligible collateral, particularly in periods of market stress. While cash collateral is efficient, fungible, and a high quality and highly liquid asset, firms may encounter challenges to posting cash, especially during periods of market volatility. Firms may not have ready access to eligible non-cash collateral because of their investment strategies and may not have the operational infrastructure and/or capacity to efficiently transform their assets to eligible collateral. These challenges can lead to increased trading, operational, and settlement costs that impact end-user performance. Firms may see an increase in transactional risks and costs associated with transformation outside of the custodian. There may be challenges with posting eligible collateral because (i) transformation is not practical or possible due to reinvestment and custodian cut-off times or (ii) it is not practical or possible to maintain excess collateral of an asset type that is not part of a fund's primary investment strategy.

We encourage CPMI-IOSCO to further consider recommendations to expand the types of eligible collateral based on appropriate risk-based eligibility principles.

3. Standardising VM processes and disclosures and increasing the alignment of payment flows will mitigate operational risks and liquidity demands

We appreciate that CPMI-IOSCO considered the scope for increasing the speed of VM pass through, aligning VM payment and collections timings with other payment flows within the same CCP, and standardising VM processes across the industry. While the Consultation concludes that universal pass through of VM is unlikely, it recommends that CCPs consider aligning VM payment and collection with other payment obligations. The Consultation does not identify any good practices related to standardisation, but rather indicates scepticism that greater standardisation can be achieved.

In response to prior margin work, we noted the importance of standardisation and alignment.[10] We acknowledge that there are challenges to increasing the standardisation of CCPs' VM processes, but caution that the heterogeneity of such process increases operational risk, clearing costs, and liquidity demands on market participants, especially in times of market stress.

Unaligned VM collection and payment cycles create timing mismatches and increase liquidity needs. The impact of such timing mismatches is exacerbated by processes that vary tremendously across CCPs and *ad hoc* intraday margin calls (which also significantly vary). The speed of margin netting varies from within an hour to longer than a day. Increasing standardisation of VM processes would reduce operational gaps and delays to the return of collateral, particularly when netting speed is increased.

Precise, expanded, and standardised disclosures regarding VM processes would bring similar benefits. Enhanced disclosures would enhance transparency to market participants, improving understanding of the procedures and facilitating planning and preparedness. We note that standardisation of the disclosures is important to avoid imprecise and uneven implementation that makes it more difficult for market participants to understand and evaluate disclosures. Standardised disclosures ensure that CCPs are put on a level footing and better prepare markets for future market stress events.

We reiterate that this should be a priority and encourage CPMI-IOSCO to expand its role in working with industry to address the challenges associated with increasing the speed of netting and minimising variations in CCPs' VM procedures. We further encourage CPMI-IOSCO to develop explicit standards for qualitative disclosures regarding VM processes that ensure clear and consistent provision of information among CCPs to all market participants.

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[10] *See*, *e.g.,* ICI Phase 1 Margin Letter

We appreciate your consideration of ICI Global's comments. If you have questions or would like to discuss our comments further, please contact Kirsten Robbins (Kirsten.robbins@ici.org) or me (ACapretta@ici.org).

Sincerely,

/s/ Annette Capretta

Annette Capretta
Chief Counsel
ICI Global