15 April 2024

BCBS Secretariat
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CPMI Secretariat
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IOSCO Secretariat
margin@iosco.org

Re: *Transparency and responsiveness of initial margin in centrally cleared markets – review and policy proposals – Consultative report*

Dear Secretariats:

ICI Global[1] appreciates the opportunity to provide comments on the Basel Committee on Bank Supervision (BCBS), Committee on Payments and Market Infrastructures (CPMI), and International Organization of Securities Commissions (IOSCO)'s consultation on transparency and responsiveness of initial margin (IM) 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

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

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 support many of the recommendations from the 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 to alleviate downstream stresses on the broader financial system. We and our members have long supported efforts to enhance the responsiveness, transparency, and governance of margin practices which will help regulated funds and other clients better prepare for future market stress events.[8]

IM is the cornerstone of CCP risk management. Yet, the methodologies for calculating cleared IM requirements are relatively opaque, leaving regulated funds and other clients without the transparency to anticipate and plan for changes to cleared IM requirements. For too long, market participants have relied on CCPs to provide transparency to little or no avail. Some CCPs have been reluctant to provide additional transparency into their practices because they believe their

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[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).

models reflect valuable and unique business strategies or have disclosed such information with long lag times that diminish the information's value.

Accordingly, we are strongly supportive of BCBS-CPMI-IOSCO's work to enhance the transparency and responsiveness of IM in cleared markets, including governance and review of the models. Understanding how IM models respond to volatility and market stresses could help regulated funds and other clients better prepare for future market stress events as market participants are able to evaluate the effectiveness of anti-procyclicality measures and find ways to avoid procyclical shocks. These measures may also mitigate the challenges associated with meeting unexpected margin calls.

We also express our support for the CM transparency proposals, which aim to bring transparency to CM IM processes. While in many cases, CMs may pass through the IM calculated by the CCP with an adjustment, CMs may use their own models in some cases. Enhancing the transparency of these processes will enhance the liquidity planning of end-users, including regulated funds. We note, however, that effectiveness of such proposals is unclear without a clearly defined path for implementation.

Despite the proposals' anticipated benefits, there are some areas where CCPs (and CMs, in some corresponding cases) would retain significant discretion. Such discretion creates uncertainty for market participants, which in turn makes it more difficult for regulated funds and other market participants to anticipate liquidity demands. We provide more detailed comments on two areas that would benefit from more explicit standards:

- In the area of transparency, we encourage the development of explicit standards for qualitative disclosures that ensure clear and consistent provision of information by CCPs to all market participants.

- In the area of governance, we recommend a more granular and explicit standard to minimise discretionary deviations and overrides.

We also reiterate below some of our prior suggestions for areas for additional work to enhance margin processes that have not yet been addressed.

1. Transparency

We strongly support the Consultation's proposals to increase transparency around cleared IM models. Variation among CCPs and CMs regarding their IM models and practices increases complexity and makes it more difficult for market participants to estimate IM requirements.

IM models are based on a number of factors, which can vary greatly. In times of stress, IM requirements increase to cover potential future exposures, based on models that may adapt automatically to market volatility and/or may be discretionarily adjusted. IM models may use any number of anti-procyclicality measures, which are implemented to avoid changes in margin requirements that could exacerbate liquidity stress. The tools and disclosures that are provided to describe IM models also vary widely in their utility. In some cases, notices of changes may be provided with less than 24 hours' notice before the changes are implemented and in language that is difficult to understand and/or subject to multiple interpretations.

The consequence of these heterogenous practices makes it difficult for market participants to replicate IM models and estimate their requirements.

In our view, the proposals in the Consultation that address margin simulators, qualitative disclosures, public quantitative disclosures, and a new standardised measure of margin responsiveness would increase the transparency of IM models and ensure more consistency among CCPs and CMs. This will improve regulated funds' and other market participants' ability to evaluate the quality of CCPs' and CMs' risk management processes.

However, the Consultation suggests that "it is often the case that the same level of granularity of information may not be necessary for different audiences."[9] The report goes on to theorise that CMs may need to "receive more detailed information about model components and calibrations than market participants or the public at large."[10] While we recognise that different types of market participants may have varying levels of sophistication, we are concerned that the proposals give CCPs discretion to determine the granularity of information to which different types of stakeholders have access. This could lead to unequal access among different stakeholders to critical information from a particular CCP as well as continue to promote variation in granularity of information by different CCPs.

To reach the objectives associated with increasing the level and detail of margin model information, CCP discretion needs to be minimised and equal access to information for all market participants should be promoted. Accordingly, we encourage BCBS-CPMI-IOSCO to develop explicit standards for qualitative disclosures that ensure clear and consistent provision of information among CCPs to all market participants.

2. Governance

We strongly support the proposals in the Consultation that address, at a general level, the governance framework for assessing model performance and taking appropriate action and, at a more specific level, the governance and review framework where discretion is applied. Enhancing governance practices goes hand in hand with increasing transparency, serving to help regulated funds and other market participants proactively plan to address IM changes. Clearing participants need to understand the circumstances in which CCPs retain discretion and the boundaries in which such discretion can be exercised.

While the proposals clearly address CCP discretion, we are concerned that the proposals do not explicitly cover exchange discretion. The LME response in the nickel markets in 2022 indicates that the exchange may retain significant discretion that effectively overrides CCP policies and

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[9] Consultation at 23.

[10] *Id.*

procedures.[11] We recommend that the proposals be revised to specifically address exchanges in addition to CCPs. We also encourage CPMI-IOSCO to consider further work to examine governance arrangements between CCPs and exchanges and ensure consistency with the Principles for Financial Market Infrastructures.[12]

In addition, we remain concerned that the proposals do not go far enough to restrict or minimise CCPs' discretion to deviate or override their standard margin practices. We appreciate that the proposals will increase the information that market participants will have regarding deviations and overrides. But even with this information, market participants cannot adequately plan for these outcomes. Discretionary deviations and overrides are unpredictable and, by definition, contradict the anticipated outcomes of the IM models. Therefore, we recommend that CPMI-IOSCO develop a more granular and explicit standard to minimise the impact of discretionary deviations and overrides.

3. Areas for further work to enhance margin processes

In response to earlier margin work, we recommended several areas for further analysis to enhance margin processes and practices.[13] We appreciate that consultations from BCBS, CPMI, and IOSCO, including this Consultation, address a number of these items.[14] As work continues, we recommend that regulators consider the following, as we previously recommended:

- Acceptable levels of procyclicality for different asset classes (*e.g.*, determining what an acceptable level of margin increase might be for broad asset classes);

- How far an IM model's "lookback" period should extend, including whether margin models should be calibrated to ensure that stress events are included;[15]

- Appropriate margin periods of risk;[16]

- Enhancing the accuracy of disclosures with requirements for third-party audit;

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[11] *See* Bank of England announces supervisory action on LME Clear (3 March 2023).

[12] CPMI and IOSCO, Principles for financial market infrastructures (April 2012).

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

[14] *E.g.,* BCBS-IOSCO, Streamlining VM processes and IM responsiveness of margin models in non-centrally cleared markets (17 January 2024); CPMI-IOSCO, Streamlining variation margin in centrally cleared markets – examples of effective practices (14 February 2024).

[15] A "lookback" period incorporates past market moves into the margin methodology, factoring in actual historical market data over the course of the "lookback" period. Since lookback periods are time based, certain historical stress events that have occurred outside of a particular lookback period may be excluded.

[16] The BCBS defines the "margin period of risk" as "the time period from the last exchange of collateral covering a netting set of transactions with a defaulting counterparty until that counterparty is closed out and the resulting market risk is re-hedged." *See, e.g.,* BCBS, The Basel Framework, Calculation of RWA for credit risk, Counterparty credit risk definitions and terminology (15 December 2019) at section CRE 50.19.

- Distinguishing recommendations for exchange-traded products and over-the-counter products; and
- Recommendations for formal CCP processes to expand eligible collateral types to reduce procyclical liquidity effects.

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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