APRIL 2024

IOSCO'S CONSULTATIONS ON IM & VM IN CLEARED AND UNCLEARED MARKETS

AFG's response

AFG

Investing in tomorrow together

The AFG federates the asset management industry for 60 years, serving investors and the economy. It is the collective voice of its members, the asset management companies, whether they are entrepreneurs or subsidiaries of banking or insurance groups, French or foreigners. In France, the asset management industry comprises 700 management companies, with €4600 billion under management and 102,000 jobs, including 27,000 jobs in management companies.

The AFG commits to the growth of the asset management industry, brings out solutions that benefit all players in its ecosystem and makes the industry shine and develop in France, Europe and beyond, in the interests of all. The AFG is fully invested to the future.

AFG'S RESPONSE

BCBS, CPMI and IOSCO launched the following discussion papers and consultative reports for which they seek input from market players:

- Discussion paper on "*Streamlining variation margin in centrally cleared markets – examples of effective practices*"
- Consultative report on "*Streamlining VM Processes and IM Responsiveness of Margin Models in Non-Centrally Cleared Markets*"
- Consultative report on "*Transparency and responsiveness of initial margin in centrally cleared markets – review and policy proposals*"

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As such, AFG would like to provide a few high-level remarks on these subjects of particular importance to its members.

As a general remark, we support these proposals intended to provide more transparency and harmonisation across the clearing ecosystem. As we saw quite recently with the COVID and the commodity crisis, it is paramount for clearing members and their clients to be able to mitigate destabilizing changes in margin requirements to avoid any other risk.

Specifically on variation margin (VM) in centrally cleared markets, we would like to raise the following remarks:

- All market participants simultaneously attempting to monetise collateral to meet ITD VM calls in volatile markets might act as a stress amplifier – introducing additional systemic risks in the market. As we have insisted on for previous years now, we would like to re-emphasize the importance of being able to post non-cash VM as it is already the case for initial margins (IM) who also need to be liquidated in case of the clearing member's default and which therefore creates no differences with VM. This is a critical issue, in particular in stressed market conditions: if VM has to be posted in cash only, it creates the need for either selling securities (including top quality ones) on the market and then amplifying the market stress, or posting them on the repo market while the market conditions make it very illiquid (and such posting amplifying again the market stress). From a Financial Stability perspective, allowing the posting of top-quality securities (such as government bonds) for covering VM calls would play a positive role in such conditions (and more widely).
- The practices that are suggested in the consultation should take into account the challenges arising from intraday (ITD) VM calls related to client positions and where CMs usually can't pass ITD margin calls to their clients because of the associated deadlines. It creates additional liquidity requirements on the CM, adding uncovered risk towards its clients. As such, ITD calculations related to client accounts should

happen on a net basis recognising that such margin is paid by the clearing member ensuring the positions.

- There is a need for more harmonization of data and processes for collateral flows across the clearing ecosystem. One way to go could be to help/encourage members and clients to start using standardised collateral representation frameworks, such as the Common Domain Model (CDM). In time, this tool could help improve collateral management efficiencies and solve a few operational challenges that are highlighted in the report.
- Moreover, it is essential to bring predictability and allow for sufficient time to deal with liquidity management. One way could be to have harmonised minimum notice periods between CCPs, that allows sufficient time to source liquidity while still enabling the CCP to cover its risk on time. Sufficient minimum notice periods should be set for changes for buffers and multipliers as well.
- Any call for ad-hoc ITD VM should be predictable which could be ensured by drafting guidelines under which conditions on when and why ad-hoc ITD VM calls can be made would be detailed, as well as provide near-real time transparency about the accumulated risk and the call thresholds so that all participants can anticipate the size of intraday VM and/or IM calls.
- For all those matters, we highly support the consultation of market participants, higher public transparency and the promotions of exchanges within the CCP risk committees (although risk committees only embed very few players, creating an asymmetry of information to the detriment of the rest of market participants).

Regarding initial margin in centrally cleared markets, here below are our main points of focus:

- We are highly in favour of better transparency on CCP's margin models with enhanced simulation tools to explain various components of Margin COB (Close of Business) and ITD, including add-ons and triggers. However, to achieve this objective, these tools should be easily interfaced by clients and not overly costly. Furthermore, disclosures on PQD (Potential Quick Defaults) should be increased and made more frequent. Transparency should also be provided on the framework for CCP discretion to ensure predictability. Harmonised practices amongst CCPs could help achieve that goal. In addition, the possible interfacing of CCP margin and risk models with APIs at no cost could also avoid manual inputs for existing and potential future trades and help ensure anticipation of IM impacts providing predictability and certainty.
- More predictability should be given during stress market events. While excessive granularity isn't necessary, market participants need predictability, especially during times of stress (e.g., the COVID crisis). Indeed, destabilizing changes in margin requirements in centrally cleared markets should be mitigated in those times to not add on liquidity pressure. Enhanced disclosures should be made regarding stress scenarios considering that CCPs have stressed-based margin add-ons. CM should inform the client with appropriate minimum notice when they are adjusting their calibration of client margin add-ons and changes for buffers or multipliers. In that way client will be in better capacity to anticipate the provision of collateral. Otherwise, insufficient notice periods in advance for margin calls by CMs towards clients may strongly and very rapidly destabilize financial markets (or at least segments of financial markets).

- We are not against proportionality based on CCPs' size provided they allow for accurate estimation and simple margin models. It is crucial that adding proportionality does not lead to uncertainty, and therefore to more OTC transactions. Furthermore, simulators serve different purposes (payments, liquidity management, stress results) and should therefore take into account the fact that they will be used by different functions and should be accessible to all, with explanations and guidance.
- We do not support prescriptive APC (Additional Price Collateral) tools. A suitable level of procyclicality, allowing CCPs freedom in implementation should be favoured. Market participants bear consequences of decisions on the balance of coverage, cost and procyclicality. As such, CCP Risk Committees should be consulted when defining the analytical framework which some parts should be made public.

Finally, regarding initial and variation margins in non-centrally cleared markets our main point is that any type of collateral (cash and non-cash) authorized under EMIR should be accepted. This is particularly useful in times of market volatility as limiting it harms Financial Stability, creates operational and liquidity constraints and pro-cyclically increases stress on financial markets.

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