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Jennifer S. Choi
CHIEF COUNSEL

MOBILE: +001 202 538 5599
jennifer.choi@ici.org

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BCBS Secretariat
baselcommittee@bis.org

CPMI Secretariat
cpmi@bis.org

IOSCO Secretariat
consultation-04-2021@iosco.org

RE: **Consultative Report on Review of Margining Practices**

Dear Secretariats,

The Investment Company Institute ("ICI"), including ICI Global,[1] appreciates the opportunity to comment on the consultative report on the Review of Margining Practices from the Basel Committee on Banking Supervision, the Committee on Payments and Market Infrastructures, and the International Organization of Securities Commissions.[2] Our collective members—regulated funds[3] in jurisdictions around the world—are significant investors in the global financial markets and have a strong interest in

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[1] ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of $41.9 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Brussels, Hong Kong, and Washington, DC.

[2] *See* BCBS, CPMI, IOSCO, *Consultative report: Review of margining practices* (Oct. 2021) ("report"), *available at* www.bis.org/bcbs/publ/d526.pdf. The report is part of the Financial Stability Board's work to enhance the resilience of the non-bank financial intermediation sector, examining whether and, if so, to what extent margin calls were unexpectedly large in centrally and non-centrally cleared derivatives and securities markets. It follows the FSB's publication calling for further work to examine "whether market participants were fully prepared for the margin calls they experienced, their ability to liquidate assets to meet margin calls under stress conditions, and the role of margining practices both in centrally cleared and bilateral markets in amplifying funding strains." *See* FSB, *Holistic review of the March market turmoil* (Nov. 2020) at 42, *available at* www.fsb.org/wp-content/uploads/P171120-2.pdf.

[3] For purposes of this letter, the term "regulated fund" refers to any fund that is organized, formed, and regulated under national law and is authorized for public sale. These funds typically are subject to substantive regulation in areas such as disclosure, form of organization, custody, minimum capital, valuation, and 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, EU UCITS, Canadian mutual funds, and Japanese investment trusts.

efforts to ensure that those markets remain robust and well-regulated. To this end, we support the Financial Stability Board's overarching goal to reduce systemic risk in the cleared and uncleared derivatives and securities markets, and support many of the report's recommendations for further work to improve margin practices following the market volatility in March 2020.

Despite the unprecedented market stress during that time, the overwhelming majority of regulated funds, including all US-domiciled regulated funds, continued to function normally and redeem shares upon demand.[4] Consistent with their normal operations, regulated funds also continued to meet their margin calls. In fact, as the report concludes, more than 93 percent of clients,[5] 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.[6] Through robust liquidity risk management programs that already are required in major markets (*e.g.*, in the United States and Europe), 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. These improvements should focus on the centrally cleared markets, and most particularly on initial margin ("IM") requirements. The report concludes that non-centrally cleared IM requirements remained relatively stable during the period, indicating that IM from uncleared products did not drive changes to market practice over the period and need not be modified as part of this exercise.[7] Further, although variation margin ("VM")

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[4] *See*, *e.g.*, ICI, Experiences of European Markets, UCITS, and European ETFs During the COVID-19 Crisis (Dec. 2020) (finding that a small percentage of regulated funds suspended redemptions for a short period, ranging from intraday to a few days, primarily due to concerns about valuation rather than the inability to meet redemption requests), *available at* www.ici.org/system/files/attachments/pdf/20_rpt_covid4.pdf; BlackRock, Addendum - Liquidity Risk Management is Central to Open-Ended Funds (Jan. 2021) (citing recent estimates that only 0.11% of fund AUM globally suspended redemptions and that no US-domiciled funds suspended redemptions), *available at* www.blackrock.com/corporate/literature/whitepaper/viewpoint-addendum-lessons-from-covid-liquidity-risk-management-is-central-to-open-ended-funds-january-2021.pdf.

[5] The report uses the term "clients" to broadly to represent firms that: manage and invest the assets of others, such as pension funds, investment managers, mutual funds, trust banks, hedge funds, etc.; manage and invest their own funds, such as family offices and insurance companies; are generally price takers and are not active market makers collecting bid/ask; and are direct clearing members of central counterparties but do not provide clearing access for other clients. *See* report at 45. The report provides much of the client-related information collectively and generally does not distinguish certain clients, such as regulated funds, from other clients.

[6] *See* report at 34.

[7] *See* report at 2, 17-18. We understand that a number of regulated funds currently are not required to post IM for their uncleared derivatives transactions. For those that did, we agree with the report's conclusion that corresponding adjustments

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requirements for both centrally cleared and non-centrally cleared products increased considerably over the period, VM reflects the change in an investment's current value and is transparent. Regulated funds and other clients expect VM changes in line with market price changes and have sophisticated tools that can readily anticipate and prepare for them. On the other hand, given the relative opaqueness of methodologies for calculating the IM requirements of central counterparties ("CCPs"), regulated funds and other clients do not have the transparency to anticipate and plan for changes to CCP IM requirements, which also increased considerably over the period and in many cases were more pronounced.[8] These IM requirements drain liquidity from a market at the same time that market participants may be seeking it. This is because IM reflects a transfer of assets from a market participant to a CCP, which removes those assets from the market, while CCPs reallocate VM received from one market participant to another leaving those assets in the market.[9]

Any further work evaluating margin practices therefore should focus on improvements to the IM requirements in the centrally cleared markets. In particular:

- We strongly agree with the report's recommendation to enhance the transparency of CCP IM models and governance practices. Requiring additional transparency would enable regulated funds and other market participants to know *ex ante* how those models will react in volatile markets to prepare for market stress events even better.

- We support further work to thoughtfully evaluate and calibrate the responsiveness of CCP IM models to market stresses. Appropriately calibrating these models could lessen the impact that sudden market moves have on IM demands. Regulators, however, should not instinctively increase centrally cleared IM requirements during "normal" times simply to avoid rapid surges in margin calls during stress periods.

- We also support enhancing and streamlining the margin collection processes in the centrally cleared markets. Enhancing these processes, including those surrounding intraday margin calls to provide transparency and operational efficiency, would promote the safe and effective operations of those markets.

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to the IM requirements for non-centrally cleared derivatives were much smaller than for centrally cleared derivatives, primarily due to the low reactivity of the Standard Initial Margin Model ("SIMM"). Margin requirements for many uncleared derivatives are based on SIMM, which is designed to respond less rapidly to volatility changes. *See*, *e.g.*, report at 10 and 21.

[8] The report concludes that differences in IM between normal times and the stress period were more pronounced than those for VM, because IM typically does not change substantially during normal times, while VM calls can be sizeable even during non-stress times. *See* report at 15.

[9] *Id*. We continue to believe that bilateral margining, including the exchange of IM, is necessary. Improvements, however, can be made to ensure the transparent exchange of appropriate amounts of IM that could enable better liquidity planning and alleviate the need for additional liquidity during market stress periods.

Various parties have already begun work that touch on many of these areas, including the US Commodity Futures Trading Commission's Central Counterparty (CCP) Risk and Governance Subcommittee of the Market Risk Advisory Committee ("MRAC"). In February 2021, the MRAC evaluated and approved recommendations across six key elements of a robust margin framework, including recommendations that CCP margin methodologies be sufficiently transparent to enable market participants to understand how models react to certain market conditions ("MRAC Report").[10] In addition, the MRAC Report recommended that regulators promote the use of scheduled/predictable event-driven and routine intraday settlement cycles to prevent the accumulation of current exposures at CCPs. We support these particular recommendations from the MRAC Report and strongly encourage regulators reviewing ways to strengthen CCP margin methodologies to consider them.

We discuss our specific views on the report below.

I. Increase Transparency of CCP IM Models and Governance Practices to Improve Client Preparedness

We strongly agree with the report's recommendation to increase transparency around CCP IM models and governance practices. CCP IM models are based on a number of factors and can vary greatly, making them difficult for market participants to replicate. During stress times, CCPs will raise their IM requirements to cover potential future exposures, relying on models that adapt automatically to market movements and/or using their own discretion to lever margin rates (*e.g.*, by changing portfolio offsets, imposing "haircuts" to collateral, and/or adding "add-ons" to account for risks such as liquidity and concentration). In addition, CCP IM models may use any number of anti-procyclicality measures to avoid changes in margin requirements that could exacerbate liquidity stress, further adding complexity to the ability of market participants to estimate CCP IM requirements. Many CCP websites that describe their margin models exclude critical parameters needed to calculate margin. Some CCPs supplement those descriptions with tools (*e.g.*, margin simulators or calculators) and other support to estimate margin, but the utility of the tools and support varies substantially. In addition, while some CCPs provide notices of changes to their margin model methodologies, those changes may be provided with less than 24 hours' notice before the changes take place and with notices that are difficult to understand.

The inability to accurately predict IM requirements tested clients during March 2020, when CCP IM moved quite significantly. Although the volatility in the markets generally outpaced the IM increases,

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[10] *See* Report of the Central Counterparty (CCP) Risk and Governance Subcommittee, Market Risk Advisory Committee of the US Commodity Futures Trading Commission, *Recommendations Regarding CCP Margin Methodologies* (Feb. 12, 2021), *available at* www.cftc.gov/media/5706/MRAC_CRGSubcommittee-DiscussionPaperOnBestPracticesinCCPMarginMethodologies022321/download.

the corresponding margin hikes were large, increasing by more than 250 percent in certain instances.[11] Regulated funds were able to meet the increases, but they and other market participants faced challenges in replicating the CCP margin models and estimating future IM increases. Due to the opacity of CCP IM models, regulated funds had little notice of IM changes, which made it difficult to proactively plan for IM increases.

Increasing transparency of CCP IM models and governance practices to show how IM and intraday margin calls are computed and called would help regulated funds and other clients understand and appropriately predict and prepare for future IM changes and improve liquidity preparedness.[12] Sufficient transparency also would allow regulated funds and other market participants to evaluate the quality of a CCP's risk management process.

Through further work in the area, regulators should enhance transparency of margin models and governance practices through more precise, expanded, and standardized disclosure to ensure that it is clear and consistent across CCPs. The disclosure should include, among other things, detailed descriptions of:

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[11] *See, e.g.,* report at 26.

[12] In this regard, the report also asks whether regulators should conduct additional work to enhance market participants' liquidity preparedness. In asking the question, the report cites to the heterogenous experiences of different clients during the stress period, noting that, while many clients did not experience significant increases in liquidity demands from margin calls, some clients experienced strains. *See* report at 34.

First, as recommended, providing additional transparency about CCP IM models and governance practices already would greatly enhance market participants' ability to predict and better prepare for any market stress scenarios, thus improving their liquidity risk management overall. The only way that market participants can prepare for market stresses is if they have sufficient information to be able to plan and prepare for those stresses.

Second, although global regulators may want to assess liquidity preparedness for clients that experienced strains, any further work in the area should exclude regulated funds. Over the last decade, global regulators have worked together to ensure effective liquidity risk management for regulated funds to safeguard the interests of their investors, maintain the orderliness and robustness of the regulated funds and markets, and reduce systemic risk to support financial stability. For example, in 2018, IOSCO, through active engagement with the FSB, set forth recommendations for regulated funds' liquidity risk management programs to ensure that regulated funds have sufficient liquidity to meet their demands. *See* IOSCO, *Recommendations for Liquidity Risk Management for Collective Investment Schemes* (Feb. 2018), *available at* www.iosco.org/library/pubdocs/pdf/IOSCOPD590.pdf. IOSCO's recommendations were comprehensive, with Recommendation 13 stating that "[t]he responsible entity should be able to incorporate relevant data and factors into its liquidity risk management process in order to create a robust and holistic view of the possible risks" (moreover, "[d]ata on liabilities such as collateral needs and potential margin calls, should be assessed alongside potential redemption demands."). Global regulators and regulated funds have already incorporated, or currently are incorporating, these principles into their regulations and liquidity risk management programs. These regulations and liquidity risk management programs appropriately address liquidity risk at the portfolio level and do not simply look at liquidity risk from marginable investments in isolation. For example, US regulated open-end funds must assess, manage, and review liquidity risk by considering multiple factors, including "the use of borrowings for investment purposes and derivatives." *See* Rule 22e-4 under the Investment Company Act of 1940.

- How a CCP's IM model typically operates, including clearly defined margin add-ons and when those would apply;

- Any anti-procyclicality tools that the CCP adopts and when those would apply;

- When and to what extent a CCP can use its discretion to change margin levels, including when and to what extent it can change portfolio offsets, increase collateral haircuts, and impose additional add-ons; and

- When and how sufficient notice describing any changes to these practices will be distributed.

Third parties should audit CCP IM models, with summaries of the audits made public, to ensure that the disclosure is accurate.

Finally, we urge regulators to *require* enhanced transparency of margin models and governance practices on a timely basis. For too long, market participants have relied on CCPs to provide their own transparency to little or no avail. Some CCPs have been reluctant to provide additional transparency into their practices because they believe their models reflect valuable and unique business strategies or have disclosed such information with long lag times that diminish the information's value. In other cases, underlying market participants in a particular market may not want certain position-level information disclosed. Further work and evaluation on a case-by-case basis can determine what specific items should be disclosed and when, with the goal of requiring detailed disclosure to enable market participants to understand and predict IM changes. Imposing transparency and timeliness requirements would put all CCPs on level footing and help regulated funds and other clients better prepare for future market stress events.

II. Evaluate the Responsiveness of CCP IM Models to Market Stresses

We also support the report's recommendation for further work to evaluate the responsiveness of CCP IM models to market stresses. As noted above, CCP IM requirements increased drastically during March 2020, creating potential challenges for clients to meet the additional margin requirements. Understanding the reasons for the large shifts through greatly enhanced transparency could help clients better prepare for market volatility and evaluate whether a CCP's anti-procyclicality measures are effective. In addition, evaluating ways to potentially dampen the size and the speed of the IM increases could help clients avoid procyclical shocks and ease the challenges they face in meeting unexpected margin requirements. We therefore support further work to evaluate the degree and nature of CCP margin models' responsiveness to volatility and market stresses, including how those models are designed and calibrated, and to assess the effectiveness of standardized tools that could lessen the procyclicality of margin models.

Further work should consider, among other things:

- 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 a CCP IM model's "lookback" period[13] should extend, including whether margin models should be calibrated to ensure that stress events are included;[14]

- Appropriate "margin periods of risk;"[15] and

- Whether and how to otherwise calibrate different margin model practices.

Although we support an evaluation of CCP IM model practices, we caution regulators and CCPs to avoid simply imposing higher IM requirements during "normal" times to reduce the amount of IM increases during market stress periods. Higher IM requirements during normal market times of course would minimize the impact of IM increases during stress times, but these *per se* increases would impact investment strategies and investors negatively, requiring more cash and collateral on hand than otherwise is necessary. Instead, any increases to standard margin requirements must be effective and imposed methodically with a concrete basis for the increase and the amount of the increase that is agreed to among all market participants.

III. Enhance and Streamline the CCP Margin Collection Processes

In addition to further work evaluating CCP IM changes, we support further work to improve and streamline the margin collection process. As with CCP IM models, CCPs employ different methods of applying and collecting margin, including VM. Margin calls can occur: (i) at preset times throughout the day; (ii) when a pre-defined market threshold is met; or (iii) *ad hoc* when margin deficits have

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[13] A "lookback" period incorporates past market moves into a CCP's margin methodology, factoring in actual historical market data over the course of the "lookback" period.

[14] Because lookback periods are time-based, certain historical stress events that have occurred outside of a particular lookback period otherwise may be excluded.

[15] 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 (Dec. 15, 2019) at Section 50.19, *available at* www.bis.org/basel_framework/chapter/CRE/50.htm#:~:text=Margin%20period%20of%20risk%20is,market%20risk%20is%20re%2Dhedged. CCPs use the margin period of risk when developing their margin methodologies, which may be based on a number of factors (*e.g.*, the product's liquidity, price, how commonly it is traded, and the overall depth of the market). *See*, *e.g.*, MRAC Report at 5-6.

reached a certain threshold. Although the first two instances generally are predictable, *ad hoc* margin calls often are not, leaving clients, including regulated funds, unable to prepare. CCPs also have different speeds at which they net intraday margin calls. Some may net margin within an hour, while others may take longer than a day, creating operational gaps when determining and collecting margin and delays to the return of collateral.

During March 2020, clients faced additional burdens from these issues. Although *ad hoc* margin calls during the period may have been limited,[16] clients, including regulated funds, often did not have transparency into the margin call process, creating issues with predicting and preparing for such calls. In addition, the relatively slow speed of margin netting combined with the increased volume of margin calls created timing mismatches for the collection of margin, which added to the need for clients to hold additional liquidity buffers.[17]

Evaluating ways to enhance and streamline the CCP margin collection process could improve operational processes and reduce settlement risk. In particular, further work could:

- Require CCPs to provide full transparency for triggers of *ad hoc* intraday margin calls;

- Evaluate how technology can enhance and accelerate the movement of margin from one counterparty to another; and

- Determine whether certain margin collection processes should be standardized throughout the CCP ecosystem.

The goal of the work in this area should be to accelerate and make margin collection transparent and efficient. It should aim to eliminate unexpected *ad hoc* margin calls to assist market participants in actively tracking and monitoring liquidity demands. It also should aim to increase the speed at which margin is collected and accounted for to avoid timing mismatches between intermediaries, which could force other market participants to retain additional and unnecessary liquidity buffers.

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[16] *See* report at 12.

[17] *See* report at 34.

Once again, ICI and its members appreciate the opportunity to comment on the report, and we look forward to engaging on any further work in these areas. If you have any questions or require further information, please feel free to contact Kenneth C. Fang, Associate General Counsel, at kenneth.fang@ici.org or 202-371-5430.

Sincerely,

/s/ Jennifer S. Choi

Jennifer S. Choi
Chief Counsel
ICI Global