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FIA Response to BCBS-CPMI-IOSCO Streamlining Variation Margin

Submitted via email to baselcommittee@bis.org, cpmi@bis.org and margin@iosco.org.

To the attention of the Basel Committee on Banking Supervision (“BCBS”), BIS Committee on Payment and Market Infrastructures (“CPMI”) and the International Organization of Securities Commission (“IOSCO”) Secretariats.

The Futures Industry Association (“FIA”) welcomes the opportunity afforded by the BCBS, CPMI and IOSCO to provide comments on their discussion paper *Streamlining Variation Margin in Centrally Cleared Market - example of effective practices*¹ (the “Discussion Paper”). The COVID crisis and Russia’s invasion of Ukraine highlighted the need for clearing participants to better understand Central Counterparties (“CCPs”) margin practices globally. This discussion paper focuses specifically on Variation Margin and provides 8 examples of effective practices: 7 practices applying to CCPs and 1 applying to Clearing Members.

FIA supports transparency in our derivatives clearing community and has published several papers over the past few years recommending CCP risk management best practices, including enhancing transparency. Most relevant are the recommendations and policy options published in our report from October 2020 *Revisiting Procyclicality: The Impact of the COVID Crisis on CCP Margin Requirements*² (the “FIA report”), which covers intraday margin amongst other topics. The FIA report highlighted that while the use of intraday margin call is an important tool for CCP risk management, it can put significant pressure on clearing members and their clients to source and deliver the appropriate collateral in a short period of time, especially if the calls are not scheduled or made late in the day. The FIA report provided several principles which are mostly aligned with the effective practices identified in this discussion paper.

FIA and its members recommend the following,

- CCPs’ scheduled intraday margin calls should:
 - Be clearly defined to all participants
 - Be made at the same time daily
 - Be made as early as possible on the business day
 - Have limits set on how late in the day they are made
 - Allow non-cash and cash collateral to cover intraday Initial Margin

¹ [Streamlining VM in Centrally Cleared Market](#) discussion paper released on 14 April by the BIS Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO).

² [Revisiting Procyclicality: The Impact of the COVID Crisis on CCP Margin Requirements](#) paper released in October 2020 by FIA

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- Allow the use of excess cash and excess non-cash collateral where available for intraday Initial Margin
- CCPs' unscheduled (or ad hoc) intraday margin calls should:
 - Be used only in times of extreme market conditions (extreme market shocks or dislocation or a member has large, uncovered exposures)
 - Have clear triggers, limits and thresholds defined to all participants
 - Apply to the relevant clearing segment only

Most importantly, the FIA report highlighted the destabilizing liquidity impact from the current asymmetry between CCPs requiring collateral within a short period of time (typically within an hour) while clearing members receive their collateral back from CCPs on a much slower time frame (typically on the next day).

In light of these recommendations, we generally support the effective practices 1 to 7, but would outline in our comments below several considerations to further develop appropriate standards for CCP intraday margin calls including Variation Margin.

The response below is structured into two main sections: Background and Comments. The Background section serves to define key terminologies used in the report and the response, such as Variation Margin (VM), Initial Margin (IM), and CCP Intraday Margin. It also clarifies the roles of different market participants and provides essential context for understanding the discussion that follows.

The Comments section is further divided into two parts. The first part discusses limitations and constraints that need to be addressed or explored further, particularly related to CCP intraday margin practices. It delves into specific methodologies and challenges faced by CCPs in managing intraday margin calls and collateral requirements. The second part of the Comments section outlines recommendations based on the effective practices presented in the discussion paper. It suggests establishing binding standards or principles for VM and intraday margin practices to benefit all market participants. Specific recommendations cover areas such as scheduled versus unscheduled intraday margin calls, collateral management, transparency requirements, and mobility of excess collateral.

While there are some differences between our specific recommendations and the proposal from the Discussion Paper, we generally support the effective practices. We share with the BCBS-CPMI-IOSCO margin working group the common goals of increasing transparency, predictability, and efficiency in managing intraday margin calls. We would like to thank the working group for the opportunity to provide comments and remain at your disposition should you need further clarifications.

Respectfully submitted,



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Background

FIA and its Members

FIA is the leading global trade organization for the futures, options, and centrally cleared derivatives markets. FIA's mission is to support open, transparent, and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry.

Variation Margin

Variation Margin is a key feature of the derivatives market consisting of settling the amount due at least daily based on the marked-to-market or settlement price of an open contract. VM settlement is usually paid or collected in cash and can be processed intraday. VM ensures that each party of the trade receives or pays the amount due, at least daily, and VM is therefore a critical risk management process limiting market risk exposures upon a default between margin calls.

Initial Margin

Initial Margin is another key feature of the derivatives market consisting of collecting sufficient collateral to cover for potential future exposures over a Margin Period of Risk ("MPOR") or closeout period. The IM usually consists of several components such as the "core" IM which typically captures the price risk of a contract or portfolio and additional margins which capture other types of risk such as concentration or liquidity risk amongst others. IM is called at least daily but can be called more frequently during the day.

CCP Intraday Margin

The discussion paper seems to be using the terms intraday Variation Margin (ITD VM) and intraday margin calls interchangeably. We believe it is crucial to make a clear distinction between the two terms as they do not necessarily share the same meaning. CCPs usually aggregate intraday Variation Margin and intraday Initial Margin (ITD IM) exposures to form the intraday margin calls. Our response makes this distinction as it is sometimes not possible to specifically discuss ITD VM without considering intraday margin call at large.

Market Participants and Clearing Participants

Some of the proposed effective practices would be of most benefit to certain group of actors, either market participants or clearing participants. We consider market participants to include the broad set of actors in the market such as clients, clearing members but also regulators and vendors. Clearing Member however represents direct clearing member of CCPs. Our response tries to identify who from this group would benefit the most from the effective practices.

CCPs role and VM/IM daily cycles

Central Counterparties ("CCPs") play a critical role in the derivative market as they act as the buyer to every seller and the seller to every buyer, ensuring contractual obligations are always met. CCPs collect Initial Margin to cover for the potential future exposures and they also act as the central point of VM collection and distribution throughout the derivative market the CCP clears.

All CCPs have a process of collecting and paying VM and IM at least daily, which is usually part of the end of day cycle. VM is collected and paid in cash and in the currency of the derivative contracts while IM can be posted in cash and non-cash collateral. Most CCPs do call for intraday margin calls to cover for the increased exposure either from new trades or intraday losses.

Liquidity implications

The Covid pandemic and the Russian invasion of Ukraine triggered large global market stress which materially impacted liquidity needs for derivatives market participants. This prompted FIA to publish its report and we are grateful for international standard setters to have considered the proposed recommendation to review CCPs margin practices including the review of CCP intraday margin calls. One key point highlighted in the report was the implication of VM and its role in driving liquidity stress and how to mitigate liquidity strains from VM.

Comments

As part of its mission statement, FIA support transparency and the implementation of best practice and standards to improve the efficiency of the derivatives market. After reviewing the 8 effective practices, FIA and its members are generally supportive of the effective practices 1 to 7 for CCPs.

However, the practices seem to be limited in terms of their enforceability as they are only intended to inform CCPs when designing their VM calls and collection process. In addition, the effective practices do not promote the establishment of binding standards which could be of benefit to market participants especially in period of stress when consistency of implementation across CCPs would be extremely valuable. We understand that there are some constraints and limitation due to the specificities of individual CCPs and the products they clear, as well as operational processes considerations, but these limitations should not hinder the establishment of VM and intraday margin best practices and standards.

In particular, we believe that there are various VM processes which CCPs have established under different terminology which could benefit standardisation. Further, CCPs might use different VM processes for different purposes and further clarity and transparency would be extremely valuable for clearing participants to better manage the associated margin calls.

Limitations and constraints

There are several constraints that a CCP might face when considering VM arrangements such as time zones operation, availability of fair value throughout the day, CCP's jurisdiction and bank holidays to name a few. We would like to outline first the two basic methods of CCP Variation Margin.

VM processes in CCPs margin calls

These methods depend on the market convention and the specifications of the products the CCP clears.

1. VM can be settled at different interval during the day and at least as part of the End of Day cycle based on marked-to-market value change during each interval or based on End of Day

settlement price. This consists of settling the VM payment in the currency of the underlying contract whereby the party suffering the loss will pay out to the party enjoying the gain. We will refer this as Settlement VM method. Most futures products follow this convention.

2. VM can also be accrued and collateralised over the lifecycle of the trade. That collateral can be usually met in cash or non-cash collateral and is added on top of the Initial Margin to form the total margin requirement. We will refer this as Contingent VM. Under this method, accrued Contingent VM gains would act as initial margin requirements credit. Such credit would be floored to a certain threshold (sometimes 0 total margin requirement, in other words, clearing participants are never on the receiving end of this type of VM but it can be used to lower their other IM requirements). This is generally the convention used for equity options, also referred to as “Equity style” margin for VM. Note also that some metals futures follow this method.

These two common methods for VM generally apply to a certain set of products or asset class, but we see exceptions in their applications with limited justifications. Further clarity and transparency as to the use and justification of a selected method would be helpful for clearing participants.

While these established methods might be used by a CCP for a specific process such as the End of Day (EoD) cycle, the methodologies do not necessarily apply consistently across all margin processes such as the intraday margin calls. For instance, products that follow a Settlement VM as part of their EoD cycle, adopt Contingent VM for the purpose of intraday calls at some CCPs. The conditions and rules applied are not clear and sufficiently transparent by CCPs, adding an extra layer of complexity when assessing margin calls implications intraday.

Eligible collateral and CCP practices of intraday margin

CCPs use different intraday practices and we summarise below the 3 main practices observed:

1. Intraday settlement VM in cash (in the currency of the underlying contract) is received and paid out by the CCP to the party suffering the loss and the party enjoying the profit. A couple of US CCPs do have this intraday.
2. Intraday collection of losses in cash or non-cash collateral by the CCP, but the CCP do not pay out or allow resulting excess collateral to be withdrawn. This seems to be the prevalent practice at CCPs.
3. Intraday collection of losses in cash or non-cash collateral by the CCP, and the CCP will adjust the total margin requirement considering intraday marked-to-market profit and loss. The CCP allows members to withdraw any excess collateral.

In addition, each CCP would apply their own notice window, parameters and have the discretion to call intraday margin late in the day. Some CCPs also have discretion to change the intraday parameters and thresholds within a short period of time to mitigate potential risk from rapidly evolving market conditions. The various practices observed across the CCPs, and sometimes within the same CCPs



operating different clearing business, as well as the CCPs substantial discretions over parameters and timings add further levels of complexity.

Fair value:

Regular fair valuations of cleared positions throughout the day could be a challenging factor limiting the use and the accuracy of intraday VM calls. While the end of day process relies on official end of day settlement prices which are well accepted by the market, intraday VMs could potentially be more challenging as not all contracts cleared at a CCP would have sufficient daily liquidity or market depth to be marked-to-market continuously.

Some CCPs might model prices using various techniques for such contracts but there could be situations where the modelled prices might substantially diverge from a fair market value, especially in times of stress. Erroneous estimation of intraday VMs could have a negative impact on market participants who could be required to pay VMs when they do not expect it, with limited way to appeal given the usually short notice on intraday calls.

This would be damaging if such erroneous VM would be paid out to a market participant and that participant would be declared in default shortly after. This could explain why some CCPs only collect intraday margin call in order to avoid this situation and why pass-through is not widely adopted by CCPs.

FIA and its members are of the opinion that intraday pass-through VM would be the optimal mechanism to increase efficiency in liquidity and risk management. We encourage this mechanism to be further explored, especially this topic of fair valuation which seems to be a key challenge in introducing a broad adoption of pass-through VM. For example, we encourage CCPs to develop their intraday pricing models in consultation with market participants ensuring these models are widely accepted and enabling accurate pass-through VM intraday.

Account segregation and operational processes:

The discussion paper note that a key factor determining the amount to be collected depends on the treatment of losses across CMs' clearing account adding that some jurisdiction regulatory framework might not provide netting benefits across accounts. Furthermore, it was noted that CCPs could not distinguish between CM House and Client flows due to operational constraint. And finally, that trade allocation or give-up processes would impact liquidity and potentially add to the operational challenges.

Time zones and bank holidays

CCPs and CMs business operations are generally global in nature and time zones as well as bank holidays are natural constraints which have potentially liquidity impact especially in period of stress. Most CMs have developed an organisational structure which enables them to operate around the clock but some firms such as end-users might not have such capabilities which could affect the sourcing and deployment of liquid resources. It should also be noted that bank holiday restricting payment obligations such as VM for contracts denominated in the affected currency usually impact liquidity and such limitations could be materially exacerbated if it would occur during a period of elevated market stress.

Recommendations

We agree that the effective practices 1 to 7 will provide useful additional context and examples for CCPs to consider when establishing their VM arrangements. We generally support these effective practices as they promote transparency and predictability for market participants, timely consideration of sourcing liquidity, optimisation of intraday components netting benefit and the eligibility of non-cash collateral.

However, we believe that binding standards or principles could be established for VM and intraday margin practices which would benefit all market participants. More specifically we would recommend that BCBS, CPMI and IOSCO consider the below in the establishment of standards or principles to be included in the PFMI.

CCP Intraday margin practices

As outlined above, CCPs usually operate 3 types of intraday margin practices. We believe that implementing the pass-through VM model would be the most effective dealing with liquidity requirements, whilst remaining effective from a risk management perspective as it would mitigate VM loss exposure in the case of a default (see above intraday margin practice #1). However, as the effective practice 4 highlighted in the discussion paper, this should be carefully examined as such method might not be appropriate for illiquid contract where fair valuation would be challenging or not appropriate in period of stress, where cash in certain currencies might be challenging to source.

Considering these potential challenges, the next best practice is for CCPs to collect losses in cash or non-cash collateral, adjust the total intraday margin requirement and allow members to withdraw any resulting excess collateral (see above intraday margin practice #3). This would alleviate to some degree the liquidity constraint face by clearing participants and provide much needed source of collateral.

We believe that CCPs should not be collecting intraday margin without providing access to excess collateral to be used by clearing participants (see above intraday margin practice #2).

While we support effective practice 5 allowing excess collateral to be used to meet intraday margin obligation, we recommend an intraday margin practice standard should also allow excess collateral resulting from intraday margin to be easily made available to clearing participants for other purpose, such as being used as collateral for another CCP.

Scheduled intraday margin calls

FIA supports the principle that CCPs should primarily use scheduled intraday margin calls, recommending effective practice 1 to be set as an intraday margin practice standard. These scheduled intraday margin calls should be made at the same time every day and should avoid disruptive hours such as late in the day. Scheduled intraday margin calls should be clearly defined and made transparent to all market participants.

Unscheduled (or ad hoc) intraday margin calls

We believe that CCPs should have the ability to risk manage prudently and therefore use unscheduled intraday margin calls when necessary. Such calls should be only used in times of extreme market conditions or when a member has material uncovered exposures. A CCP that has appropriately calibrated the timings of its scheduled intraday margin calls should only rarely need to use unscheduled calls.

The triggers and thresholds for ad hoc unscheduled calls should be fully transparent to clearing participants and we strongly recommend ensuring that clearing participants are aware of the upcoming liquidity need when issuing a call notice and have sufficient transparency as to the drivers (either coming from new trades and/or which products suffering intraday loss) to take appropriate actions before the intraday margin call is due. We recommend the CCP not to process the ad hoc call if the clearing participants has taken appropriate actions to reduce its exposures below the triggers and thresholds during the call notice. This would mitigate the potential duplicative use of clearing participants' liquidity resources, which could be scarce especially during time of stress.

Eligible Collateral

CCPs should have the ability to establish whether their intraday calls are aggregated between VM and IM or called separately.

For CCPs that aggregate VM and IM, and therefore does not operate “pass-through VM”, the CCP should allow intraday calls to be covered by non-cash collateral as well as excess non-cash collateral.

For CCP that apply intraday VM and IM separately, to the extent possible, intraday VM should be paid and received in cash (in the currency of the contracts allowing for pass-through VM). The CCP should allow intraday IM to be covered by non-cash collateral as well as excess non-cash collateral. We acknowledge the use of VM pass-through should be carefully examined by CCPs, as per effective practice 4, especially considering the limitation of fair value and availability of banking hours, as well as the impact of cash needs during period of stress. Market participants might consider cash as a more challenging collateral to source during period of stress, and therefore use of non-cash collateral could reduce the liquidity strains on these participants.

House and Client Accounts

We noted from the report that CCPs have different ways of offsetting against clients and house accounts³. We recommend that offsetting rules should always ensure client segregation rules to the extent possible

³ Section 2.1.3, page 9 of the Discussion Paper, “CCPs indicated that their legal frameworks were quite different and, as a result of some regulations, CCPs either are not required (and therefore may be unable) to distinguish between client and house accounts, or are prohibited from netting VM requirements between a CM’s house and client accounts. Some CCPs cite operational barriers to distinguishing between CMs’ house and client flows”.

We also note that some CCPs have identified operational challenges in determining positions or trades amongst clients' accounts and house account. We believe that CCPs should have an accurate view of intraday trades and positions at granular intervals and therefore would encourage these CCPs and regulators to ensure these operational constraints are limited and do not impair appropriate intraday risk management at portfolio or account level.

Transparency requirements

We strongly support effective practice 6 recommending that it should be set as an intraday margin standard. We recommend that CCPs clearly defined to all participants their scheduled and unscheduled intraday margin calls including the routine time for scheduled calls, whether IM and VM are aggregated or treated separately (use of Settlement VM or Contingent VM), the collateral eligible, the details of the calculations, the netting arrangements across accounts, the relevant timelines and notices as well as the availability of excess collateral amongst others.

We strongly recommend that the CCPs provide a detailed breakdown of the calculation presenting the initial margin and intraday PnLs of the positions for each relevant account. This will allow participants to better understand the driver and take any appropriate actions if required.

Ideally, we would recommend that CCPs include in their margin simulation tools (as per the 2024 BCBS-CPMI-IOSCO Margin Transparency and Responsiveness report) features that would provide intraday capabilities such as intraday VM and IM change against the relevant triggers and thresholds. This could also benefit from a drilldown analysis at account and position level.

With regard to CMs providing their clients transparency of their process and timing for intraday calls (effective practice 8), we believe that this effective practice is already generally met by CMs and we question if the feedback from the 3 clients surveyed is a fair representation on which to establish such effective practice. We recommend that further assessment of such requirement be considered.

Flexible excess collateral mobility

We would like CCPs to allow any excess collateral to be transferred back to the member on demand intraday. This feature in addition to the availability of a margin simulation tool providing intraday views of exposures versus relevant thresholds and trigger would prove invaluable. Especially during time of stress, where excess collateral posted at a CCP could be a source of liquidity to meet requirements at another CCPs, having such features would certainly alleviate some of the liquidity constraints.

Annex A: Proposed Effective Practices

1. Increasing the predictability of ITD margin calculations and collections to the extent practicable. This could be achieved by using, or increasing the frequency of, scheduled ITD margin calculations and collections where appropriate, after carefully considering the trade-off between the following:
 - a. the increased operational burden associated with making more scheduled ITD calls, as well as the positive impact of using ad hoc calls when it is prudent; and
 - b. the corresponding decrease in the probability of ad hoc ITD calls, as well as the positive impact on clearing members' operational readiness and financial capacity to meet the scheduled calls.
2. Giving participants sufficient time to manage the liquidity impact of an ITD call, while also considering the need to collect VM on a timely basis in order to mitigate the build-up of current exposures.
3. Where allowed, practical and efficient, offsetting VM calls against other payment obligations, such as initial margin calls and product payment flows (eg coupons), in order to reduce liquidity demands on participants.
4. Reviewing its operational practices based on an evaluation of the feasibility and the pros and cons of passing through ITD VM to mitigate the liquidity impact of ITD calls on participants.
5. Subject to agreement with the CM or client and where legally and operationally feasible, allowing the use of excess collateral to meet ITD VM obligations.
6. Providing information regarding the CCP's processes and timing for ITD VM calls in order to facilitate its participants' ability to predict and manage liquidity requirements. This could be achieved by clearly defining and making available to participants (through the CCP's rulebook or other relevant documentation) the following:
 - a. the circumstances and any related thresholds according to which the CCP may make ITD VM calls;
 - b. the timing and relevant notice periods for its ITD VM calls;
 - c. the CCP's processes and rules concerning the netting of payments across margin accounts for each type of margin call, where excess collateral can be used to meet VM requirements, and any other provisions which have an impact on the amounts to be called from CMs; and
 - d. granular information to help CMs understand the composition of VM calls, which may include items such as: a unique identifier to track the call across the CCP's systems, an indicator of whether the call relates to initial margin/variation margin/default fund/rights of assessment/other, a house/client account indicator, underlying unique portfolio/account identifiers, details of any offsets netted against other payments (such as other margin calls, securities deliveries and receipts or coupon payments), a breakdown of the calculation which sets out the individual elements comprising the

total, the forms of eligible collateral or the quantity and forms of eligible excess collateral which may be used to satisfy the call, and details of the deadline(s) for meeting the call.

7. Seeking feedback on the CCP's VM practices from its participants and other relevant stakeholders (eg through risk committees or other established mechanisms) in order to aid the CCP's assessment of the trade-off between managing its own risks and the interests of its participants.
8. Providing transparency to clients regarding the CM's processes and timing of ITD VM calls, which may facilitate clients' ability to predict and manage liquidity requirements. This could be achieved by clearly defining and making available to clients details of the following aspects of the VM calls it issues:
 - a. its practices and procedures for the calculation and collection/payout of VM;
 - b. schedules for timely payment that its clients may be required to meet; and
 - c. its rules and practices concerning:
 - i. the usage and forms of excess collateral eligible for meeting VM calls;
 - ii. acceptance and transformation of non-cash collateral for the purposes of meeting VM calls; and
 - iii. netting arrangements across client accounts

Annex B: Questions

Overarching questions

1. Do you agree that the eight effective practices identified in this report foster market participants' preparedness for above-average VM calls through the efficient collection and distribution of VM in centrally cleared markets?
2. Are there any other effective practices, mechanisms or changes that would streamline VM processes in centrally cleared markets which have not been covered in this report? If so, please describe such practices.

Effective practices

3. For each effective practice identified in this report:
 - a. Do you agree that it is an effective practice?
 - b. What are the pros and cons (including unintended consequences) of the effective practice?
 - c. Please discuss any drawbacks or hurdles to implementing the effective practice.
 - d. Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.