ISDA-IIF Response to the CPMI-IOSCO discussion paper
"Streamlining variation margin in centrally cleared markets – examples of effective practices"

Executive Summary

Members of the Institute of International Finance (IIF) and the International Swaps and Derivatives Association (ISDA, together the Associations) welcome the proposed Effective Practices set out in the CPMI-IOSCO Discussion Paper on streamlining variation margin (VM) in centrally cleared markets (the Discussion Paper), focusing on intraday (ITD) VM processes.

The Associations are supportive of the Effective Practices on frequency, scheduling and timing, pass through of VM, excess collateral, CCP to clearing member (CM) transparency, which would foster market participants' preparedness for above-average VM calls. Regarding Effective Practice 8 on transparency from CM to clients on ITD VM calls, we highlight, as acknowledged in the Discussion Paper, that most CMs do not pass-on ITD VM calls to their clients and hence this information would not be relevant to such clients.

Streamlining ITD VM processes should be focused on limiting the amount of liquidity that is trapped at the CCP intraday. Achieving this objective would not only help market participants' liquidity preparedness, but also mitigate the risk that ITD VM calls act as an amplifier in stress circumstances, thereby reducing systemic risks.

As regards the Effective Practices proposed by CPMI-IOSCO, we note that clearing members' preference is for scheduled ITD VM calls, as opposed to unscheduled. We suggest that Effective Practice 1 regarding the frequency/scheduling of CCP ITD VM calls should be considered in conjunction with Effective Practice 2 on ITD VM calls payment deadlines,[1] acknowledging that these cannot be extended beyond a certain point. CCPs should discuss the approach to scheduling ITD VM calls with CMs, through consultation of the CCP Risk Committee, or other committees, such as risk working groups.

We emphasise that wherever practically possible, CCPs should endeavour to pass-through ITD VM, to reduce the amount of liquidity that is trapped during the day in times of high volatility. Where CCPs do not pass-through ITD VM, then market participants should be allowed to meet ITD VM calls with a wider set of collateral. Providing wider flexibility for market participants to meet ITD VM calls would be valuable, even if the next end-of-day or

[1] We use the terminology "payment deadlines" to refer to the time window within which CCPs ask clearing members to meet an ITD margin call. We acknowledge that the report refers to "notice period" in recommendation 6. However, given that "notice period" is also used in a different context in the BCBS-CPMI-IOSCO consultation on transparency and IM procyclicality, we chose to use a different terminology to avoid any confusion.

beginning-of-day VM call will ultimately have to be met in cash. CCPs that do not pass-through ITD VM should also explore solutions such as Effective Practice 3, allowing market participants to offset VM payments against other payment flows, where practical. We suggest a similar practical solution, whereby participants that are owed ITD VM would be allowed to offset this amount against their IM requirements.

In developing these Effective Practices, we would see value for CCPs to explain how their ITD VM arrangements have been designed in consideration with paragraph 5.2.26 of the CPMI-IOSCO CCP resilience guidance, which sets out that CCPs should consider how ITD VM arrangements *"interact with other components of its margin system and how it can, to the extent practicable and prudent, limit the potential for liquidity implications".*[2]

Finally, as regards potential other Effective Practices not outlined in the report, we highlight that initiatives aimed at reducing frictions in collateral operations would also help to mitigate the liquidity impact of ITD VM calls. In that regards, wider adoption of standardised collateral representation framework, such as the ISDA Common Domain Model (CDM),[3] should be encouraged.

This response covers the positions of our members on the buy-side and sell-side. The paper does not reflect the views of many CCPs, and many of the CCPs are in disagreement with the views.

Responses to 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?

We agree that the Effective Practices on frequency, scheduling and timing, pass through of VM, excess collateral, CCP to CM transparency would foster market participants' preparedness for above-average VM calls (practices 1 to 7).

We understand the focus on preparedness, but note that the key objective of streamlining ITD VM practices should be to limit the liquidity impact on the market by reducing the extent to which liquidity is trapped at the CCP. In addition, reducing frictions in collateral operations might help mitigate the liquidity impact of ITD VM calls.

As regards the Effective Practice 8 on CM to client transparency, we would highlight that most clearing members do not call for, or pass on, ITD VM calls to their clients – a point that is acknowledged in the report.

[2] Resilience of central counterparties (CCPs): Further guidance on the PFMI (bis.org)

[3] The CDM is a standardized data and process model for how financial products are traded and managed across the transaction lifecycle. More information on the ISDA CDM is available here: CDM – International Swaps and Derivatives Association (isda.org)

We also note, as recognised in the Discussion Paper, that there are limitations and constraints to implementing the Effective Practices in certain situations – with impediments arising from time zones, bank holidays, account segregation, client money rules, and operational processes.

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.

Encouraging collateral efficiency initiatives

The report highlights the operational challenges arising from ITD VM calls that market participants may face, especially in stressed market circumstances, when the need to collect VM promptly is particularly acute. More harmonization of data and processes for collateral flows across the clearing ecosystem (particularly as it relates to divergent data and collateral flows at CCPs), through greater use of standardised collateral representation frameworks, such as the ISDA Common Domain Model, could help improve efficiencies in collateral management. Some of the operational challenges highlighted in the report could be addressed by resorting to the standardisation efforts enabled by the CDM.

Ability to access repo markets for collateral transformation

Another consideration is that because ITD VM calls have to be met in cash, the extent to which repo markets can be relied upon in stress circumstances will be key to ensure that ITD VM calls do not place liquidity pressures on market participants. This underlines the importance of the ongoing FSB work on repo market resilience, as part of its broader Non-Bank Financial Intermediation work programme.[4]

Considering the extent to which collateral other than cash could be posted as ITD VM

Under stressed market circumstances, market participants might not be able to raise liquidity through outright sale or repos of collateral in a timely manner, or they might only be able to do so at significant discounts if dash-for-cash dynamics develop. 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. Ways to post collateral other than cash to meet ITD VM calls is therefore worth exploring further, even if we acknowledge the associated challenges. In particular, we would invite standard setters to consider the way the ITD VM call is treated by the CCP – i.e. whether it is passed-through or not –, and what this means for allowing non-cash to be posted. While the preference is for CCPs passing through ITD VM, to reduce the amount of liquidity trapped at the CCP, where the CCP does not pass-through ITD VM, it should be expected to accept non-cash collateral for ITD VM purposes. Having the choice of a wider

[4] We understand the FSB is planning some work on that topic, as set out in the forward work plan included in the last NBFI progress report, Enhancing the Resilience of Non-Bank Financial Intermediation: Progress report (fsb.org)

set of collateral to meet ITD VM calls would be valuable to market participants, even if the subsequent end-of-day or beginning-of-day VM call will ultimately have to be settled in cash. However, we do acknowledge that for CCPs that do pass-through ITD VM calls – which they should strive to – then there is no option other than cash. In that regard, please refer to the appendix for an explanation why VM has to be paid in cash.

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.

Effective practice 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.

a. Do you agree that it is an effective practice?

Generally, ISDA members prefer scheduled ITD VM calls, as these are easier to predict, at least in terms of timing. Should a CCP have to make unscheduled calls, it should publish guidelines under which conditions extraordinary ITD VM calls would be made, whether these would be made across all participants or for specific participants only, whether such unscheduled calls would be passed through, and under what circumstances they would not be passed through.

In general, for scheduled and unscheduled ITD VM calls, CCPs should provide near-real time transparency about the accumulated risk and the call thresholds to each participant, so all participants can anticipate the size of ITD VM and/or IM calls.

b. What are the pros and cons (including unintended consequences) of the effective practice?

We agree with the pros and cons of this Effective Practice, as outlined in the report – i.e. more frequent scheduled ITD calls might increase the operational burden on clearing members, but comes with the benefit of reducing the likelihood of large, unscheduled ITD calls.

c. Please discuss any drawbacks or hurdles to implementing the effective practice.

Though not a hurdle strictly-speaking, we suggest that CCPs discuss what the optimal frequency of ITD VM calls should be with CMs, through consultation of the CCP risk committee and/or other groups where member and client input can be solicitated and discussed, for instance risk working/advisory groups.

More frequent scheduled ITD VM cycles will have some risk-reducing benefits but CCPs, in consultation with clearing participants, should weigh up such benefits with the operational burden of having to fund these extra cycles.

In discussing this trade-off, CCPs should provide their users with an analysis of how they have factored in paragraph 5.2.26 of the CPMI-IOSCO CCP resilience guidance, which sets out that CCPs should consider how ITD VM arrangements *"interact with other components of its margin system and how it can, to the extent practicable and prudent, limit the potential for liquidity implications"*.[5]

d. Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.

We do not see any alternative to this Effective Practice.

Effective practice 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.

a. Do you agree that it is an effective practice?

We agree that this is an Effective Practice, but note that from a CCP resilience perspective, a longer payment deadline would defeat the purpose of the ITD VM call. We also question how this Effective Practice might work in conjunction with Effective Practice 1: if the preference is for more frequent, scheduled ITD VM calls, then payment deadlines cannot be extended beyond a certain limit. Otherwise, in times of high volatility, the yet-to-be-met ITD VM call would overlap with a potential newly issued ITD VM call.

[5] Resilience of central counterparties (CCPs): Further guidance on the PFMI (bis.org)

b. What are the pros and cons (including unintended consequences) of the effective practice?

Providing market participants with sufficient time can only help with liquidity management. Payment deadlines for meeting ITD VM calls should be part of a CCP's policy on ITD VM, developed in consultation with clearing participants. We however note that the time between margin call and payment cannot be too long, as otherwise the CCP would not be sufficiently covered against risk.

The payment deadline should allow market participants to source the required liquidity and operationally meet the ITD VM payment. However, as noted above in response to question a, we question the extent to which a payment deadline can be extended in a way that would work with Effective Practice 1: if the preference is for more frequent, scheduled ITD VM calls, then the payment deadline cannot be extended beyond a certain point.

c. Please discuss any drawbacks or hurdles to implementing the effective practice.

As highlighted in the report, the practices on payment deadlines vary across CCPs and business lines, also depending on whether the ITD VM call is scheduled and unscheduled. It would be helpful to ensure that CCPs have clear policies on this, developed in consultation with the CCP Risk Committee, also considering the scheduled frequency of ITD VM calls, per Effective Practice 1.

d. Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.

We would suggest that the implementation of this Effective Practice be considered in conjunction with Effective Practice 1, so that the payment deadline fits appropriately with the scheduling of ITD VM calls.

Effective practice 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.

a. Do you agree that it is an effective practice?

We support this as an Effective Practice. We have a similar practical suggestion: if a CCP is not able to pay out ITD VM, it could offset the unpaid amount of ITD VM (which a participant did not receive) with appropriate haircuts against IM requirements. This would reduce liquidity requirements: if a clearing participant would be owed ITD VM, but does not get it paid it out, this participant would receive a "credit" for the amount of ITD VM, which could be used to recall some IM, if operationally possible. This would be akin to the "equity-style" margin model,

adopted by some CCPs for options, where the variation in the market value of the option can be offset against IM requirements.

The mechanics of the "IM credit" approach that we suggest could work as follows:

- at the beginning of the day, clearing participant A's account shows an IM requirement of 100. Clearing participant A holds a position on the opposite side of clearing participant B's position.
- intraday volatility leads to a variation in the mark-to-market move of 10:
  - clearing participant A experiences a positive mark-to-market gain of 10;
  - clearing participant B experiences a mark-to-market loss of 10;
- the CCP calls clearing participant B for 10 in ITD VM, which clearing participant B fulfils, but the CCP does not pass this through to A.
  - the CCP's current exposure with B is therefore covered: there is now 10 worth of collateral (in the form of cash, or bonds with appropriate haircuts) sitting with the CCP.
- without passing through the collateral worth 10 received from B, which stays with the CCP, the CCP would credit A's IM account with 10. Clearing participant A's IM account now shows an excess amount of collateral worth 10, which it can withdraw from its IM account while still meeting its unchanged amount of IM requirement, at 100. This requirement would be covered by 90 of IM and 10 credit from unpaid (by the CCP) ITD VM.

b. What are the pros and cons (including unintended consequences) of the effective practice?

We do not see any apparent unintended consequences from implementing this Effective Practice.

c. Please discuss any drawbacks or hurdles to implementing the effective practice.

We do not see any drawback or hurdle to implementing this Effective Practice – CCPs should in any event be able to identify which payment flow corresponds to what.

d. Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.

As noted above in response to sub-question a, we suggest a similar effective practice – whereby a clearing member who is owed ITD VM, but does not get it paid out, could net the unpaid amount of ITD VM against its IM requirements.

Effective practice 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.

a. Do you agree that it is an effective practice?

We agree that there would be value in CCP reviewing their practices and evaluate the feasibility of passing through ITD VM. Where possible (absent obstacles arising from time zone or currency mismatches), there should be an expectation that a CCP passes through ITD margin. This would also eliminate some of the asymmetric practices from CCPs where the ITD ad-hoc margin calls only happen when the clearing member is out of the money. It should be two-way.

If ITD VM is not passed-through, then the CCP should consider alternative solutions to limit the liquidity impact of ITD VM, such as by accepting a wider set of collateral for ITD VM purposes, as noted above in our response to question 2, and by offsetting ITD VM payments to members and clients with initial margin excess collateral or other payment obligations.

b. What are the pros and cons (including unintended consequences) of the effective practice?

In jurisdictions where the local currency can be paid over the whole trading day and the CCP does not have meaningful exposures in other currencies, the CCP should be in a position to pay out ITD VM.

c. Please discuss any drawbacks or hurdles to implementing the effective practice.

The suggested Effective Practice, consisting in a review of existing practices, should not come with any drawbacks or hurdles.

However, one hurdle to margin pass-through relates to time zones and currencies: where the local currency cannot be paid over the whole trading day, or the CCP clears transactions in other currencies than the currency of the home jurisdiction (especially currencies in other time zones), it might be more difficult to request payment of ITD VM in transaction currency.

d. Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.

As regards the hurdle arising from time zones and currencies, a solution could be that the CCP defines a time window for each currency in which ITD VM has to be paid in the transaction currency, and in which ITD VM will also be paid out.

Should there be mark-to-market moves outside the normal liquidity window which the CCP deems not to be market data noise, it would be acceptable to call VM on a collateralized basis and not pass through during these times.

Even so, we would expect most of the activity to naturally take place at times where respective currencies can be passed through.

For this reason, we believe that implementing this time window approach to VM pass-through would result in significantly reducing the liquidity impact of ITD VM on market participants.

Effective practice 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.

a. Do you agree that it is an effective practice?

We agree that this is an Effective Practice, but would note that regarding clients, CM do not usually pass ITD calls on to clients. This proposal therefore might not be relevant for the majority of clients. Some clients posting excess collateral with their CM intend for this to be used for future trades only. So, if their excess collateral is used to meet ITD VM obligations, this might hamper their ability to trade in future, if their excess collateral has been used to meet ITD VM calls. Given the overall liquidity benefit of this practice, we propose for the CCP to offer it, if possible, but leave it to agreements between CM and client as to whether excess collateral can be used for ITD VM calls.

b. What are the pros and cons (including unintended consequences) of the effective practice?

There could be unintended consequences arising from this practice if the use of excess collateral to meet ITD VM obligations is applied in a one-size-fits-all manner. However, the Discussion Paper acknowledges that such practice should only apply subject to agreement with the CM and client (though as noted in response to question a, this practice might not be relevant vis-à-vis clients that do not pay ITD VM), and where legally and operationally feasible. We agree with these limitations and would encourage CCPs and CMs to discuss how and when excess collateral can be used to meet ITD VM obligations.

c. Please discuss any drawbacks or hurdles to implementing the effective practice.

Whether to implement this practice – allowing the CCP to use the excess collateral left by a CM to meet ITD VM calls – will ultimately depend on what the CM has agreed with the CCP as regards the use of excess collateral.

There might be hurdles to implementing the Effective Practice as regards non-cash excess collateral. CCPs, in consultation with CMs, should explore the possibility to offset non-cash excess collateral against ITD VM obligations, with appropriate haircuts.

d. Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.

We do not see any alternative to this Effective Practice, which should be adopted following agreement between the CCP and its CMs, as noted above.

We note that in relation to this Effective Practice, the report discusses the interaction between ITD VM and the subsequent end-of-day (EoD) or beginning-of-day (BoD) VM call. We agree that this is a key aspect to consider when looking to mitigate the liquidity impact of ITD VM. However, it is not explicitly addressed by this Effective Practice. We would encourage CCPs to consider, in consultation with their members, how to ensure a seamless reconciliation of ITD VM flows with subsequent EoD or BoD VM calls, to avoid a situation where, following an EoD or BoD VM call, a clearing participant has paid an ITD VM call and is being subsequently called EoD or BoD VM in relation to the same current exposure and currency, without recognition for ITD VM previously called. We understand that some CCPs request EoD or BoD VM calls to be paid in full, even if the CM might have provided cash in the same currencies already as part of a prior ITD VM call.

Ensuring this reconciliation would also be an effective way to demonstrate implementation of the expectation set out in paragraph 5.2.26 of the CPMI-IOSCO CCP resilience guidance, which we also refer to in relation to Effective Practice 1, which sets out that CCPs should consider how ITD VM arrangements *"interact with other components of its margin system and how it can, to the extent practicable and prudent, limit the potential for liquidity implications".*[6]

Effective practice 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.

a. Do you agree that it is an effective practice?

As noted in response to Effective Practice 1, ISDA members prefer scheduled ITD VM calls. A CCP should publish guidelines setting out under which conditions extraordinary VM calls would be made and whether these would be made across all participants or for specific participants only.

b. What are the pros and cons (including unintended consequences) of the effective practice?

More information will help with market participant preparedness. However, we appreciate that under certain extreme circumstances, the CCP might need to deviate from pre-established timings for ITD VM calls. As noted above, the CCP should clarify ex-ante how it would go about issuing such extraordinary VM calls, and the circumstances under which it might issue such extraordinary VM calls.

[6] Resilience of central counterparties (CCPs): Further guidance on the PFMI (bis.org)

c. Please discuss any drawbacks or hurdles to implementing the effective practice.

There should not be any drawbacks or hurdles to implementing this practice – CCPs should provide information on their ITD VM processes, and consult with market participants, for example by involving the CCP Risk Committee, when developing the policies underpinning these processes.

Appropriate information on ITD VM process is mutually beneficial for CCPs and CMs.

d. Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.

There is no alternative to this Effective Practice, which should be the baseline expectation: CCPs should provide information on their processes and timing for ITD VM calls.

Effective practice 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.

a. Do you agree that it is an effective practice?

We strongly support CCPs consulting their market participants, e.g. through the CCP risk committee or other committees, like risk working groups, on the CCP's adopted VM practices policy. This policy should include all the considerations covered under the Effective Practices set out in this Discussion Paper and other effective practices proposed in this response.

b. What are the pros and cons (including unintended consequences) of the effective practice?

We do not see any con or unintended consequences from this suggested practice.

c. Please discuss any drawbacks or hurdles to implementing the effective practice.

We do not see any drawbacks or hurdles to implementing this suggested practice. As noted in relation to Effective Practice 6, ITD VM practices should be developed by the CCP in consultation with its clearing participants, appropriately consulting the CCP risk committee.

d. Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.

As for Effective Practice 6, there is no alternative to this Effective Practice. CCPs seeking feedback on their VM practices from clearing participants should be the baseline expectation.

Effective practice 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.

a. Do you agree that it is an effective practice?

We agree that clients should be aware of the CCPs' processes and how these translates into potential calls from the CM to the client. Whether ITD VM calls are passed on to the client or not will depend on the client's ability to do so and commercial negotiations. Detailed information about the CCP's and the CM's processes is only relevant if the clients want to pay and receive ITD VM.

This suggested practice does not address the challenges arising from ITD VM calls related to client positions: CMs often do not and cannot (given the associated deadlines) pass intraday margin calls to their clients. Passing on ITD VM calls to clients would be particularly operationally complex for clients in omnibus accounts. One issue arising from this practice is that ITD VM calls related to client account create additional liquidity requirements on the CM, adding uncovered risk towards the client for the clearing member. Therefore, there is a need to review and ensure intraday calculations by the CCPs related to client accounts happen on a net basis recognizing that such margin is paid by the clearing member guaranteeing the positions.

b. What are the pros and cons (including unintended consequences) of the effective practice?

As noted above, we think that this proposed practice does not address the actual issue arising from ITD VM calls linked to client positions.

c. Please discuss any drawbacks or hurdles to implementing the effective practice.

This Effective Practice is only partially relevant to the question of streamlining ITD VM processes, given that most clearing members do not pass on ITD VM to their clients – as acknowledged in the report.

d. Are there better, more efficient, more cost-effective alternatives to the effective practices? If so, please describe them.

Rather than focusing on transparency from CM to clients with regards to ITD VM, which is only partially relevant for reasons stated above, the focus should be on ensuring that CCPs calculate ITD VM related to a clearing members' client accounts on a net basis.

Appendix: Why non-cash collateral cannot be used for cleared variation margin[7]

In uncleared markets, non-cash assets can be posted as VM. This is because for uncleared transactions, VM is posted as collateral to cover a credit exposure of the accumulated loss of a portfolio. The expectation is that the assets are returned once the credit exposure no longer exists, for instance because transactions in the portfolio mature/expire or are closed out. Posting non-cash is possible because the counterparties in an uncleared setting know each other's identity and know who these assets have been posted to.

In cleared markets, variation margin is a daily payment of the mark-to-market change of a portfolio compared to the previous day. In CCPs that use the settled-to-market (STM) model, which is used by most futures CCPs and some OTC derivatives CCPs, VM actually settles the daily profit or loss of a position. For CCPs using the collateralised-to-market (CTM) model, variation margin technically collateralises the accumulated exposure as in uncleared markets, but practically payment flows are the same as under the STM model. Under both models, the daily VM requirement is equal to the daily change in the mark-to-market of a position[8]. Therefore, there is no practicable way of exchanging such VM in other assets than cash in the transaction currency. Firstly, the party on the other side of a clearing participant might use its cleared transactions to hedge other assets, and might require the VM payment to be in cash so they can satisfy any payment obligation linked to the hedged assets. Secondly, if VM was to be paid in non-cash assets whose value can change depending on the market, either the receiver(s) would run the risk that the asset loses value before it could be liquidated, or the payer would have to deliver assets with a haircut, which would be costly for the payer.

One could imagine a set-up where VM could be paid in non-cash assets. In this set-up, clearing participants that owe VM to the CCP would post assets to cover the accumulated exposure to the CCP. The CCP would then either be allowed to re-hypothecate these assets and post them to clearing participants that are owed VM, or the CCP could give those clearing participants an IM credit. Over time, this credit might however be larger than the actual IM requirement. It would also not be clear what the CCP would do if a clearing participant closes out an in-the-money position. At the latest at this point, the profit would have to be settled in cash. It is not clear how the CCP would be able to generate this cash, and whose posted VM assets it would have to liquidate. Also, in a default situation the CCP would have to liquidate more non-cash collateral, which would make the CCP riskier. Overall, such a model might trap even more assets than the current clearing model. Participants could also not use such a CCP for hedging of other assets or risks, as they would not receive a payment flow to allow them to pay obligations linked to these other assets.

[7] As outlined in our response, for ITD VM that is not passed-through, then CCPs should consider non-cash collateral as eligible.

[8] There might be other components, for instance, for a swap, coupon payments are included in VM. There is also a margin component called price alignment interest, which is an adjustment for the funding cost of the posted collateral.

One would also expect for cost of transactions cleared at such CCP to be higher, as they would incorporate the cost of trapped assets.

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 77 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on X, LinkedIn, Facebook and YouTube.

About IIF

The Institute of International Finance (IIF) is the global association of the financial industry, with about 400 members from more than 60 countries. The IIF provides its members with innovative research, unparalleled global advocacy, and access to leading industry events that leverage its influential network. Its mission is to support the financial industry in the prudent management of risks; to develop sound industry practices; and to advocate for regulatory, financial and economic policies that are in the broad interests of its members and foster global financial stability and sustainable economic growth. IIF members include commercial and investment banks, asset managers, insurance companies, professional services firms, exchanges, sovereign wealth funds, hedge funds, central banks and development banks.