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Adding predictability to resiliency: the post-Covid challenges of margining

The Covid outbreak in spring 2020 triggered extreme market moves in some financial sectors like equity markets. In addition, the global financial system had to adapt quickly to lockdown measures that were imposed in all jurisdictions. In this unprecedented context, EU CCPs and their members proved remarkable financial and operational resilience. Margin collection continued smoothly, without any member default and EU CCPs deployed business continuity plans to carry out their activities on a fully remote basis.

While this crisis has showed that post-2008 reforms were useful, including clearing mandates and CCP regulations, some events at global level have raised questions on the preparedness of actors, especially the liquidity capacity of some non-banks to meet higher margin calls. EMIR is a robust framework for CCP resilience that involves close cooperation and supervisory convergence and has just been complemented by a regulation on recovery and resolution. Yet, EU authorities pay close attention to the above-mentioned vulnerabilities, and have therefore undertaken policy work at ESMA and ESRB level to enhance the stability of the clearing chain.

Financial actors need more predictable margin practices, without weakening CCPs' first defense lines. In this respect, the clearing membership of EU CCPs should remain subject to high liquidity and operational standards. Similarly, collateral eligibility should remain limited to highly liquid assets, and any broadening should be closely monitored to ensure this does not create additional liquidity risk for CCPs.

Predictability should help limiting margin procyclicality. Margins should be calibrated so that their level would remain adapted through the economic cycle, while smoothening peaks and troughs. More specifically, authorities should deal in priority with fluctuations of initial margin models and monitor discretional changes. While EMIR already requires CCPs to implement anti-procyclicality tools in their IM models (e.g. floors, buffers) they could be subject to further guidance, including possible steering power from authorities and transparency. More generally, CCPs could disclose more granular, frequent data on margin breaches and increases. EU authorities could develop enriched disclosure standards in this regard.

Beyond CCPs, and to better consider liquidity strains at ecosystem level stemming from margin requirements, transparency should be improved on uncleared markets and vis-à-vis client clearing practices. End-users might be subject to liquidity pressures through collateral restrictions or add-ons set by clearing agents or bilateral counterparties. In June 2020, the ESRB issued recommendations on this issue that national authorities are now implementing.

While the EU should not wait to take action, international standard-setting bodies will have a key role to play too. While CCPs are a sizeable part of the question and the CPMI-IOSCO Quantitative Disclosures could be refined, we welcome the holistic approach on assessing margin practices in the financial sector that FSB, CPMI-IOSCO and BCBS have together embraced. We think this ambitious work will result in substantial supervisory outcomes and proposals.