CRE Finance Council
The Voice of Commercial Real Estate Finance

Margin Requirements for Uncleared CMBX

Margin Rules Are Onerous and Onboarding for Clearing Uncertain

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Executive Summary

- **Over-the-Counter (OTC) Margin Requirements:** Five agencies, including the Commodity Futures Trading Commission (CFTC), Federal Reserve (Fed), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and the Securities Exchange Commission (SEC), adopted rules requiring the posting of variation margin, or the mark-to-market change in value, on a daily basis for non-cleared swaps.

- The rule triggered cost increases stemming from the requirement to post margin on bilateral CMBX traded under the non-cleared margin rules, which came into force on September 1, 2017.

- **A Gap in Macro-prudential Regulation:** Post-crisis, regulators identified oversight of OTC derivatives/swaps as one of the greatest gaps in the global regulatory framework. At the center of the Dodd-Frank Act chapters addressing OTC markets are standard margin practices.

- **Onboarding Products onto a New Clearing Platform Is a Lengthy Process:** The target exchange first gathers risk and performance data from dealers, then analyzes the data and assesses margin requirements and possibly capital and liquidity requirements. The regulators must approve the facility's requirements after reviewing the data and validating the clearing house's models.

- **CMBX Treatment:** While indexes, such as CMBX, typically have not posed outsized risk to the financial system, the idiosyncratic nature of CMBX and CRE products typically attract higher capital and liquidity charges. CREFC is working in all of these areas to guard against unnecessarily punitive treatment of these products.

Margin Rule Quick Facts

- CMBX falls into the most punitive treatment bucket for non-cleared swaps.
- Zero percent of the AAA and junior AAA CMBX tranches referenced in Series 1 (2006) through Series 11 (2017) have defaulted.
- Swaps and derivatives markets are global, which necessitates that regulators around the globe harmonize rules.
- CFTC Chairman J. Christopher Giancarlo has amplified the need for better cross-border coordination on over-the-counter swaps rules to avoid imperiling the largest markets and the network of clearing facilities worldwide.
- Clearing houses have so far focused on plain-vanilla products, creating a bottle neck for onboarding of credit risk products, especially those like CMBX that are relatively more idiosyncratic.

Resources

- CFTC Fact Sheet Regarding Uncleared Swaps Margin Requirements Rules
- CFTC's Final Rule
- Joint Agencies' Final Rule

For further Information, visit CREFC's Resource Center at: https://www.crefc.org/library

Potential Solutions

- **Market Participants Agree Most Expedient Path Is to Ensure CMBX Becomes a Cleared Instrument:** CREFC members are now working to move CMBX onto clearing facilities. CREFC is acting as a facilitator in streamlining the onboarding process where possible.

CREFC Policy & Strategy

CREFC members broadly support any measure that enhances CMBS/CMBX liquidity. With this imperative, CREFC has agreed to represent the industry in ensuring timely onboarding at one or more clearing facilities. At this time, CREFC does not intend to seek revisions to current requirements.

Additional Background & History

- **How the Rules Work and Who Complies:** Collectively, the rules promulgated by the five agencies (Fed, FDIC, OCC, SEC, and CFTC) cover nearly all dealer entities and require that OTC derivatives be slotted into appropriate buckets by risk, requiring varying levels of initial margin. Since the industry voiced its initial concerns, CMBX market makers have begun to work in earnest with at least one clearing house to onboard CMBX.

- **Problems with the OTC Derivatives Regulatory Framework:** There are many problems with overall OTC derivatives regulation, the central one being that risks could be concentrated in a few entities, as opposed to being spread across market participants. The CFTC's Chairman J. Christopher Giancarlo maintains that assessing central counterparties (CCPs) with capital charges on top of margin requirements assumes that the CCPs retain the risk and emphasizes balance-sheet safety over market liquidity. Moreover, Giancarlo believes that the CCPs are not in need of balance sheet fortification. The Commissioner also maintains that because swaps rules are so complex, it is impossible for large players to perform the functions of clearing and settlements for themselves.