Derivative Margin Calls: A New Driver of MMF flows?

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Discussion by
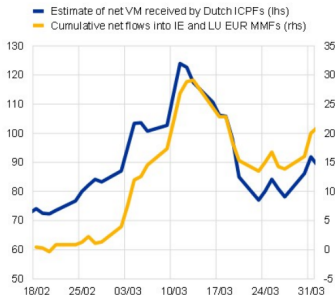Alba Patozi
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Background:

- Margin requirements are an important safeguard to reduce counterparty credit risk
- However, margin calls are highly pro-cyclical
- This could have significant implications for liquidity risk during episodes of financial distress
- Exacerbated liquidity risk may give rise to perilous price spirals and contagion through network effects

This paper:

- Asks: What is the effect of Derivative Margin Calls on Money Market Funds?
- Combines three unique and very granular datasets
- Provides strong evidence that some insurance companies, investment funds and pension funds used MMFs to manage liquidity needs arising from margin calls in March 2020
- Potential implication: Recent regulatory reforms in the derivative markets (i.e. daily exchange of margins) may increase liquidity risk and create spillovers in money markets

Some Comments:

- **Spillovers to money markets:** Does the liquidity squeeze in MMFs result in money market stress? (i.e. MMF Net Asset Values, Repos, Commercial paper?)

- **Investment groups constraints:** To what extent have these margin calls amplified the liquidity constraints of MMF investors? (i.e. delays in margin repayments, liquidated positions?)

- **Decomposition:** How else are these investment groups funding their liquidity needs? (Bank credit lines? Are they perhaps liquidating their euro area sovereign bond positions too?)

- **Portfolio nalysis:** Type of portfolios? What component of variation margins is responsible for the MMF outflows? (Can we break down variation margins into two components: (i) sensitivity of CCP margin models to market volatility (ii) broker portfolio repositioning)

- **Role for policy:** To what extent did the Pandemic Emergency Purchase Programme (PEPP) alleviate some of these liquidity concerns?

- **External validity:** Recent oil/commodity market disruption