

MEMO# 28264

July 14, 2014

ICI Global Comment Letter on EU Consultation Paper on Margin Requirements for Uncleared Derivatives

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 25-14
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 45-14
ICI GLOBAL MEMBERS No. 24-14
INTERNATIONAL MEMBERS No. 24-14
SEC RULES MEMBERS No. 31-14 RE: ICI GLOBAL COMMENT LETTER ON EU CONSULTATION PAPER ON MARGIN REQUIREMENTS FOR UNCLEARED DERIVATIVES

Today, ICI Global submitted a comment letter to the European Securities and Markets Authority, the European Banking Authority, and the European Insurance and Occupational Pensions Authority (collectively “European Supervisory Authorities” or “ESAs”) on their consultation paper on draft regulatory technical standards (“RTS”) for margin requirements for non-centrally cleared OTC derivatives. [\[1\]](#)

The letter was submitted on behalf of US funds that are regulated under the Investment Company Act of 1940 (“ICA”) and non-US regulated funds publicly offered to investors (collectively, “Regulated Funds”). The comment letter supports the ESAs’ efforts to transpose the agreed upon international standards into the RTS [\[2\]](#) and applauds the incorporation of many key elements of the BCBS/IOSCO Standards in the draft RTS. The letter argues, however, that in two critical areas – collection of margin and application of the threshold for initial margin – the draft RTS are contrary to the intent of the international standards. The letter also states that certain modifications are necessary to the RTS to make the standards more workable for market participants.

Specifically, the letter makes the following recommendations on the draft RTS:

- The RTS should require EU entities to post and collect initial and variation margin when transacting with non-EU counterparties as well as with EU counterparties. Requiring only the collection of margin by EU entities from non-EU counterparties would eviscerate the benefits of universal two-way margining as a method of reducing counterparty risk and the buildup of systemic risk.

- The RTS should not require counterparties to take a capital charge if they do not collect margin below the initial margin threshold. A requirement to take a capital charge in lieu of collecting margin below the threshold either would effectively eliminate the threshold because counterparties would not want to take a capital charge or would limit the availability of the threshold to entities that are subject to capital requirements.
- The RTS should require models developed by one counterparty for initial margin to be transparent to, and replicable by, the other counterparty. Full transparency would assist in verifying that margin is calculated appropriately and would allow the other counterparty to use the model to post and collect margin.
- The RTS should not impose a concentration limit for sovereign debt issued by certain countries that is both highly liquid and high quality. Indeed, we believe that the ESAs should be encouraging counterparties to use precisely this type of collateral to safeguard the derivatives markets.
- The RTS should adopt a phase-in period for the variation margin requirements similar to the phase-in for initial margin to provide adequate time for documentation between counterparties to reflect the numerous amendments that would be required to bring existing documentation into compliance with the RTS.

Jennifer S. Choi
Senior Associate Counsel Securities Regulation

[Attachment](#)

endnotes

[1] Consultation Paper on Draft Regulatory Technical Standards on Risk-Mitigation Techniques for OTC-Derivative Contracts Not Cleared by a CCP under Article 11(15) of Regulation (EU) No. 648/2012, April 14, 2014, available at http://www.esma.europa.eu/system/files/jc_cp_2014_03_cp_on_risk_mitigation_for_otc_derivatives.pdf ("Consultation Paper"). ICI's Memorandum summarizing the Consultation Paper is available at http://www.ici.org/my_ici/memorandum/memo28043.

[2] Margin Requirements for Non-Centrally-Cleared Derivatives, Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, September 2013, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD423.pdf> ("BCBS/IOSCO Standards").

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