MEMO# 29559

December 17, 2015

ESMA Publishes Consultation Paper Concerning the Liquidation Period Applied by Central Counterparties for Calculating Client Margin; Member Response Requested by January 4

[29559]

December 17, 2015

TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 89-15
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 62-15
REGISTERED FUND CPO ADVISORY COMMITTEE
SECURITIES OPERATIONS ADVISORY COMMITTEE RE: ESMA PUBLISHES CONSULTATION PAPER CONCERNING THE LIQUIDATION PERIOD APPLIED BY CENTRAL COUNTERPARTIES FOR CALCULATING CLIENT MARGIN; MEMBER RESPONSE REQUESTED BY JANUARY 4

The European Securities and Markets Authority ("ESMA") recently issued a Consultation Paper on the review of regulatory technical standards ("RTS") concerning the liquidation period applied by central counterparties ("CCPs") for the calculation of client margin. [1] Comments on the Consultation Paper are due by February 1, 2016. If you have concerns about the Consultation Paper, please contact Jennifer Choi at jennifer.choi@ici.org or (202) 326-5876 or George Gilbert at george.gilbert@ici.org or (202) 326-5810 by close of business on January 4.

The Consultation Paper proposes to revise existing RTS that establish a two business day minimum liquidation period for financial instruments other than over-the-counter ("OTC") derivatives. The paper arises in the context of equivalence and recognition of U.S. CCPs under the European Market Infrastructure Regulation ("EMIR"). In the U.S., the minimum liquidation period for financial instruments other than OTC derivatives is one day, applied for client accounts on a gross basis, but EMIR RTS currently provide for a two day minimum liquidation period applied on a net basis. [2]

To reduce the risk of regulatory arbitrage, ESMA proposes to modify the EMIR RTS to permit a CCP to use a one day minimum liquidation period for financial instruments other than OTC derivatives held in client omnibus accounts and individual segregated accounts that meet four conditions. First, the CCP would be required to handle positions and calculate client margin requirements on a gross basis. Second, the CCP would need to know the identity of the client to ease porting of a client's portfolio in the event of a clearing member default. Third, the client could not be part of the same group as the clearing member. Finally, the CCP would be required to implement procedures to calculate, for each account, initial and variation margin requirements at least every hour during the day using updated positions and prices and to collect the margin within one hour where the new margin requirement is higher than 120% of the updated available collateral for the position, unless the margin call would not be material under thresholds established by the CCP. CCPs would be permitted to continue offering net omnibus account structures, but would be required to use a two-day liquidation period for these accounts.

Jennifer S. Choi
Associate General Counsel

George M. Gilbert
Counsel

endnotes

[1] See European Securities Market Authority, Consultation Paper, Review of Article 26 of RTS No 153/2013 with respect to MPOR for client accounts (Dec. 14, 2015), available at https://www.esma.europa.eu/system/files_force/library/2015-1867_consultation_paper_on_mpor.pdf?download=1. ESMA released a Discussion Paper on this topic earlier this year. See ICI Memorandum No. 29311, available at https://www.iciglobal.org/iciglobal/pubs/memos/memo29311.

[2] Under "gross" margining, clearing members must pass to the CCP enough margin to cover the sum of the separate margin requirements for each client's position, with no netting of exposures between clients. Under "net" margining, clearing members need only pass to the CCP sufficient margin to secure the net exposure across a set of clients whose positions are held in the same omnibus account. Under the net margining regime, clearing members may retain much of the client margin. ESMA noted that the amount of margin held at a CCP using the gross margining method and the one day liquidation period is generally higher than margin calculated according to the net margining method with a two day liquidation period. ESMA also noted, however, that a one day minimum liquidation period for gross margin may result in less margin collected by the system as a whole.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.