

MEMO# 29820

April 8, 2016

ESMA Publishes a Final Report Concerning the Liquidation Period Applied by Central Counterparties for Calculating Client Margin

[29820]

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 13-16
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 14-16
REGISTERED FUND CPO ADVISORY COMMITTEE
SECURITIES OPERATIONS ADVISORY COMMITTEE RE: ESMA PUBLISHES A FINAL REPORT
CONCERNING THE LIQUIDATION PERIOD APPLIED BY CENTRAL COUNTERPARTIES FOR
CALCULATING CLIENT MARGIN

The European Securities and Markets Authority (“ESMA”) recently issued its final report on the review of regulatory technical standards (“RTS”) concerning the liquidation period applied by central counterparties (“CCPs”) for the calculation of client margin. [\[1\]](#) The final report would revise the existing RTS to allow a one business day minimum liquidation period for financial instruments other than over-the-counter (“OTC”) derivatives under certain conditions. This memorandum briefly summarizes the draft RTS in the final report. Unless otherwise noted, these RTS are consistent with ESMA’s consultation on this topic in December of 2015. [\[2\]](#)

The draft RTS are intended to reduce the potential for regulatory arbitrage as a consequence of the common approach to CCP regulation that the European Commission and the U.S. Commodity Futures Trading Commission (“CFTC”) agreed to earlier this year. [\[3\]](#) 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 RTS under the European Market Infrastructure Regulation currently provide for a two day minimum liquidation period applied on a net basis. [\[4\]](#)

To reduce the risk of regulatory arbitrage, the draft RTS would permit a CCP to use a one day minimum liquidation period for financial instruments other than OTC derivatives held in a client omnibus account or individual segregated account that meets five 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 all clients that have

positions in the account. [5] Third, the positions held in the account could not be proprietary positions of entities in the same group as the clearing member. [6] Fourth, the CCP must measure exposures and calculate initial and variation margin requirements for each account on a near to real-time basis, at least every one hour during the day. Finally, if the CCP does not allocate new trades to each client during the day, the CCP must collect margin within one hour where the margin required for the unallocated positions exceed 110% of the available margin balance, unless the amount of the intraday margin to be paid is not material under predefined standards established by the CCP. [7]

The European Commission has three months to determine whether to endorse EMSA's draft RTS.

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endnotes

[1] See European Securities Market Authority, Final Report, Review of Article 26 of RTS No 153/2013 with respect to MPOR for client accounts (April 4, 2016), available at https://www.esma.europa.eu/sites/default/files/library/2016-429_final_report_review_of_article_26_of_rts_no_153-2013_with_respect_to_mpor_for_client_accounts.pdf.

[2] See ICI Memorandum No. 29559 (December 17, 2015), available at <https://www.iciglobal.org/iciglobal/pubs/memos/memo29559>.

[3] See ICI Memorandum No. 29776 (Mar. 18, 2016), available at <https://www.iciglobal.org/iciglobal/pubs/memos/memo29776>.

[4] 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 across 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 more of the client margin than under a gross margining regime.

[5] ICI Global's comment letter on the proposed RTS supported this requirement because we expect that it would ease porting of a client's portfolio in the event of a clearing member default.

[6] This condition differs from ESMA's proposal, which would have prohibited the client from being part of the same group as the clearing member. ESMA believes the change will enhance the ability of affiliates of clearing members to provide indirect clearing services to clients on a one-day gross basis.

[7] ESMA's proposal included an intraday margining requirement that would have applied to all trades in an account, not just unallocated trades. ICI Global's comment letter on the proposal urged ESMA to remove the intraday margin requirement and to replace it with a standard that would more closely follow CFTC rules for CCPs.

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