

MEMO# 29950

June 1, 2016

Draft ICI Global Letter to European Commission on Margin Requirements for Uncleared Derivatives; Member Feedback Requested by Friday, June 3

[29950]

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 25-16
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 23-16
INTERNATIONAL COMMITTEE No. 30-16
SECURITIES OPERATIONS ADVISORY COMMITTEE RE: DRAFT ICI GLOBAL LETTER TO
EUROPEAN COMMISSION ON MARGIN REQUIREMENTS FOR UNCLEARED DERIVATIVES;
MEMBER FEEDBACK REQUESTED BY FRIDAY, JUNE 3

As previously reported, the European Securities and Markets Authority, the European Banking Authority, and the European Insurance and Occupational Pensions Authority (collectively, “European Supervisory Authorities” or “ESAs”) recently issued final draft regulatory technical standards (“RTS”) for margin requirements for non-centrally cleared over-the-counter (“OTC”) derivatives (“covered transactions”). [\[1\]](#) The draft RTS have been submitted to the European Commission for review and the Commission must decide whether to endorse the RTS “as is” or whether to recommend changes by June 8.

An ambiguity in the draft RTS could cause variation margin requirements to take effect for physically settled foreign exchange (“FX”) forward contracts earlier than anticipated. ICI Global has drafted a letter urging the European Commission to clarify this ambiguity to ensure that market participants have sufficient time to comply with margin obligations. Please send written comments on the draft to George Gilbert (george.gilbert@ici.org) by close of business on Friday, June 3.

Our draft letter notes that Article 39(6) of the draft RTS provides that variation margin requirements for FX forwards would apply on the earlier of: (1) December 31, 2018; or (2) the “entry into force” of the Commission Delegated Acts referred to in Article 4(2) of Directive 2014/65/EU (“MiFID II”) related to the definition of physically settled FX forwards. In the “Background and rationale” section of the draft final RTS, the regulators describe Article 39(6) as a “delayed application” and a “postponement” of the variation margin requirement to ensure that a common definition of FX forwards exist at the European Union

level before margin requirements apply. [2]

Unfortunately, a literal reading of Article 39(6) could accelerate the compliance date for FX forward contracts rather than delay it. The Delegated Act establishing a uniform definition of FX forward contracts for the EU may be finalized and enter into force as soon as August. Therefore, under this literal reading of the RTS, market participants, including funds, could be required to comply with the margin requirements for FX forwards by August.

We believe that this result would contravene the intention of the ESAs to give market participants additional time to comply with margin requirements for FX forwards. Moreover, if this illogical but literal reading of the RTS is retained, the compliance date under Article 39(6) would be the same for all entities, so smaller entities would not benefit from any additional compliance period as they would for other derivatives. [3]

To avoid this unfortunate result, the draft letter recommends a modest change to the text of Article 39(6). Specifically, we believe that the RTS should apply margin requirements for FX forwards from the date of application of MiFID II—rather than the date of entry into force of the Delegated Acts on FX forwards—which is expected to be January 3, 2018. This modification would achieve the ESAs' stated objective of postponing variation margin requirements for FX forwards to permit market participants time to understand the scope of their obligations under the new definitions.

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Counsel

[Attachment](#)

endnotes

[1] Final 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, March 8, 2016, available at <http://www.esa.europa.eu/documents/10180/1398349/RTS+on+Risk+Mitigation+Techniques+for+OTC+contracts+%28JC-2016-+18%29.pdf>. For a summary of the draft final RTS, see ICI Memorandum No. 29785 (March 22, 2016), available at https://www.ici.org/my_ici/memorandum/memo29785.

[2] Draft Final RTS at 13.

[3] Under the compliance timeline in the Draft Final RTS, variation margin requirements generally would apply from September 1, 2016 for covered transactions between very large counterparties and from March 1, 2017 for other covered transactions.