MEMO# 29311

September 2, 2015

ESMA Publishes Discussion Paper Relating to Clearinghouse Margin Methodology; Response Requested by September 9

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 66-15
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 43-15
REGISTERED FUND CPO ADVISORY COMMITTEE
SECURITIES OPERATIONS ADVISORY COMMITTEE RE: ESMA PUBLISHES DISCUSSION PAPER RELATING TO CLEARINGHOUSE MARGIN METHODOLOGY; RESPONSE REQUESTED BY SEPTEMBER 9

The European Securities and Markets Authority ("ESMA") recently issued a discussion paper seeking input on the regulatory technical standard relating to the liquidation period applied by central counterparties ("CCPs") for the calculation of margin. [1] Specifically, ESMA is considering whether it would be appropriate to revise the current regulatory standard establishing a two business day minimum liquidation period for financial instruments other than over-the-counter ("OTC") derivatives. [2]

Based on the input received, ESMA will determine whether to prepare a revised draft technical standard to be included in a consultation paper. Comments on the Discussion Paper are due by September 30. At this time, the Institute is not expecting to submit comments in response to the Discussion Paper. If you believe that we should comment on the Discussion Paper or on any of the specific questions raised (see below), please contact Jennifer Choi at jennifer.choi@ici.org or (202) 326-5876 or Kenneth Fang at kenneth.fang@ici.org or (202) 371-5430 by close of business on September 9.

ESMA raises the issue 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 only one day applied for client accounts on a gross basis, whereas under EMIR, the minimum liquidation period is two days applied on a net basis. [3] ESMA noted that the amount of margin held at the CCP using the gross margining method with the one day liquidation period is (typically, but not always) higher than margin calculated according to the net margining method with the two day liquidation period. ESMA also stated, however, that a one day minimum liquidation period for gross margin may result in less margin collected by the system as a whole. Because of these differences and to avoid regulatory arbitrage, the European Commission requested ESMA's recommendations. The Discussion Paper notes that ESMA's review would not affect the outcome of the European Commission's equivalence analysis.

Accordingly, ESMA has posed the following questions:

Q1: ESMA welcomes views on the assumption that client margins maintained at CCP level on an Omnibus Segregated Account ("OSA") gross margining with one-day liquidation period would generally be higher than margin held at the CCP under an OSA net with a two-day liquidation period. Please, provide quantitative analysis on the effect of the reduction of margin on the basis of 2 vs. 1 day Margin Period of Risk ("MPOR") and of the net (between clients' positions) margining vs gross margining. Please also consider the potential impact of the case in which a one-day OSA gross is considered equivalent to the EU system and the Regulatory Technical Standards ("RTS") are not changed and the impact for the whole system if the MPOR at CCP level is reduced.

Q2: If the RTS were modified to allow one-day gross margin collection for Exchange-Traded Derivatives ("ETDs"), should this be extended to financial instruments other than OTC derivatives? What are the costs and benefits of either approach?

Q3: If a differentiation of MPOR is made for ETDs depending on the gross or net collection of margins, should this differentiation be made for OTC derivatives as well? Would seven days MPOR for OTC derivatives be appropriate for net OSA? Please, provide quantitative analyses in support of your answer.

Q4: Should Individual Segregated Accounts according to EMIR ("ISAs") and gross OSA be treated equally in terms of MPOR? Please provide quantitative evidence to support your arguments.

Q5: Do you consider that specific conditions should apply in order to ensure that margins are called intraday in case the MPOR is reduced to 1-day under a gross client margins collection?

Q6: Do you agree that entities of the same group as clearing members should not be allowed to benefit from a lower MPOR even if they chose an OSA gross or ISA account? What are the costs and benefits of either approach?

Q7: Do you consider that specific conditions (e.g. compulsory pre-existing arrangement with a back-up clearing member) should apply in order to enhance the portability of client positions in order to benefit for the gross margining with one-day liquidation period? What conditions in your view would enhance the portability of client accounts? What are the costs and benefits of the suggested condition? Is it feasible that each client in an OSA would nominate a back-up clearing member or could this be a practical impediment to the establishment of gross margining? Is it feasible to expect an alternative clearing member to guarantee to accept porting of a client's positions in the event of the primary clearing member's default?

Q8: Is there any other aspect or concern that ESMA should consider when reviewing Article 26 with respect to client accounts?

Jennifer S. Choi
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Assistant General Counsel

endnotes

[1] See European Securities Market Authority, Discussion Paper, Review of Article 26 of RTS No 153/2013 with respect to client accounts (Aug. 26, 2015), available at http://www.esma.europa.eu/content/Discussion-Paper-review-Article-26-RTS-153-2013 (“Discussion Paper”).

[2] See Article 26 of RTS No 153/2013. Under a minimum liquidation period, a CCP should be able to either transfer or liquidate a defaulting clearing member’s position, and have sufficient margins to cover the exposures arising from the transfer or liquidation of the relevant position.

[3] 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, and so the clearing members may retain much of the client margins.
