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EU Authorities Publish Draft Amendments on Variation Margin Requirements for Physically-Settled Foreign Exchange Derivatives Contracts

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TO: ICI Members
ICI Global Members SUBJECTS: Derivatives
International/Global RE: EU Authorities Publish Draft Amendments on Variation Margin Requirements for Physically-Settled Foreign Exchange Derivatives Contracts

The European Supervisory Authorities ("ESAs") published draft regulatory technical standards ("RTS") that would exempt certain entities (including registered investment companies and UCITS) from the requirement to post variation margin for physically-settled foreign exchange derivatives contracts ("FX contracts").[1] In particular, the draft RTS would limit the requirement to collect variation margin for physically-settled FX contracts to only transactions concluded between "institutions" (credit institutions and investment firms) as defined under the Capital Requirements Regulation ("CRR").[2]

The ESAs published the draft RTS to align the treatment of variation margin for physically-settled FX contracts with other jurisdictions, which otherwise might put European Union ("EU") counterparties at a disadvantage, especially for EU institutions trading with non-EU counterparties.

The ESAs acknowledge that the amendments likely will not be finalized until after January 3, 2018 (the date when the requirement to exchange variation margin for physically-settled FX contracts is due to take effect). Therefore, consistent with their November statement regarding challenges for certain counterparties in exchanging variation margin for physically-settled FX contracts by January 3, 2018, the ESAs reiterated their position that, for institution-to-non-institution transactions, national competent authorities should apply the EU framework in a risk-based and proportionate manner until the amended RTS enter into force.[3] As of this date, a number of national competent authorities have issued or provided guidance consistent with that approach.[4]

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Attachment

endnotes

[1] *See* Draft regulatory technical standards on amending Delegated Regulation (EU) 2016/2251 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to 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 with regard to physically settled foreign exchange forwards (Dec. 18, 2017), *available at* https://esas-joint-committee.europa.eu/Publications/Technical%20Standards/Joint%20Draft%20RTS%20on%20margin%20requirements%20for%20non-centrally%20cleared%20OTC%20derivatives%20(JC-2017-79).pdf. The draft RTS would only provide an exemption for physically-settled FX forward contracts.

[2] The scope of the requirements applies only to "institutions" within the meaning of the CRR, i.e., credit institutions and investment firms, or with an equivalent entity located in a third country that would meet the definition of "institution" if located in the EU. We understand that the term excludes registered investment companies and UCITS, but members may want to consult with their own legal counsel to confirm what entities are within the scope of the term.

[3] *See* Variation margin exchange for physically-settled FX forwards under EMIR (Nov. 24, 2017), *available at* https://esas-joint-committee.europa.eu/Pages/News/Variation-margin-exchange-for-physically-settled-FX-forwards-under-EMIR-.aspx. For a summary of the statement, see ICI Memorandum No. 30959 (Nov. 27, 2017), *available at* https://www.iciglobal.org/iciglobal/pubs/memos/memo30959. ICI Global, in conjunction with four other trade associations, had submitted a letter urging European regulators to defer and reconsider VM requirements for FX contracts. *See* ICI Memorandum No. 30894 (Oct. 3, 2017), *available at* https://www.iciglobal.org/iciglobal/pubs/memos/memo30894.

[4] *See* Central Bank of Ireland, Markets Update (Dec. 19, 2017), *available at* https://www.centralbank.ie/regulation/markets-update/article/issue-10-2017/central-bank-of-ireland/statement-on-the-variation-margin-requirements-under-emir-for-physically-settled-fx-forwards ("The Central Bank confirms that, in accordance with the recommendation from the ESAs and pending the outcome from their review, the Central Bank will apply its risk-based supervisory powers in the day-to-day enforcement of applicable legislation in a proportionate manner."); Statement of German Trade Associations Summarizing Federal Financial Supervisory Authority (BaFin) Statement on the RTS Amendment (Dec. 12, 2017) (attached) (in German); Financial Conduct Authority, Variation margin requirements under EMIR for physically settled FX forwards (Dec. 7, 2017), *available at* https://www.fca.org.uk/markets/emir (". . . we will not require firms whose physically settled FX forwards are likely to be outside the scope of the amended requirements to continue putting processes in place to exchange variation margin.").