

COMMENT LETTER

January 27, 2016

ICI Global Comment Letter to ESMA on the Liquidation Period Applied by Central Counterparties for Calculating Client Margin (pdf)

14 December 2015 Reply form for the consultation paper on Review of Article 26 of RTS No 153/2013 with respect to MPOR for client accounts

1 Responding to this paper The European Securities and Markets Authority (ESMA) invites responses to the questions listed in this Consultation Paper on Review of Article 26 of RTS No 153/2013 with respect to MPOR for client accounts, published on the ESMA website. Instructions Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

- use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
- do not remove the tags of type - i.e.: the response to one question has to be framed by the 2 tags corresponding to the question; and
- if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

- if they respond to the question stated;
- contain a clear rationale, including on any related costs and benefits; and
- describe any alternatives that ESMA should consider.

Naming protocol In order to facilitate the handling of stakeholders responses please save your document using the following format: ESMA_REVIEW_OF_MPOR_NAMEOFCOMPANY_NAMEOFDOCUMENT. E.g. if the respondent were XXXX, the name of the reply form would be: ESMA_REVIEW_OF_MPOR_XXXX_REPLYFORM or ESMA_REVIEW_OF_MPOR_XXXX_ANNEX1 To help you navigate this document more easily, bookmarks are available in “Navigation Pane” for Word 2010 and in “Document Map” for Word 2007. Deadline Responses must reach ESMA by 1st February 2015. All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input/Consultations’.

2 Publication of responses All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA’s Board of Appeal and the European Ombudsman. Data protection Information on data protection can be found at www.esma.europa.eu under the heading Legal Notice.

3 Introduction What is the category

you belong to? CCP: ☐ Clearing member: ☐ Client of a clearing member: ☐ Other: ☒, please specify: Trade association, asset management Please make your introductory comments below, if any: ICI Global appreciates the opportunity to provide feedback on the consultation paper issued by the European Securities and Markets Authority ("ESMA") on the review of Article 26 of regulatory technical standards ("RTS") No. 153/2013 with respect to the margin period of risk ("MPOR" or "minimum liquidation period") for client accounts ("Consultation Paper"). The consultation arises in the context of equivalence and recognition of U.S. central counterparties ("CCPs") under the European Market Infrastructure Regulation ("EMIR"). In the U.S., the minimum liquidation period for financial instruments other than over-the-counter ("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. The Consultation Paper would amend the RTS to permit CCPs to offer a client omnibus account where margin is calculated on a gross basis with an MPOR of one business day for financial instruments other than OTC derivatives. As the international arm of the Investment Company Institute, ICI Global serves a fund membership that includes investment companies that are registered under the Investment Company Act of 1940 and other regulated funds in jurisdictions around the world (collectively, "regulated funds"), with combined assets of US\$19.4 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC. Regulated funds use derivatives in a variety of ways. Derivatives are a particularly useful portfolio management tool in that they offer regulated funds considerable flexibility in structuring their investment portfolios. Uses of derivatives include, for example, hedging positions, equitizing cash that a regulated fund cannot immediately invest in direct equity holdings, managing a regulated fund's cash positions more generally, adjusting the duration of a regulated fund's portfolio, or managing a regulated fund's portfolio in accordance with the investment objectives stated in a regulated fund's prospectus. 4 ICI Global generally supports ESMA's proposals. Our members, as market participants representing millions of investors, have a strong interest in ensuring that the derivatives markets are highly competitive and transparent and that central clearing is encouraged where appropriate to reduce systemic risk. Because most derivatives transactions are conducted on a cross-border basis, we have a strong interest in real and meaningful coordination among regulators on derivatives regulation to avoid duplicative and/or conflicting regulation. We believe the draft RTS would promote a consistent global regulatory framework for the clearing of non-OTC derivatives and reduce opportunities for regulatory arbitrage. We further believe that the draft RTS would provide increased protections to the collateral posted by our members to secure their cleared positions. Our responses to the questions raised in the Consultation Paper are provided below. 5

Questions from the consultation paper Do you have any comment on the draft RTS in Annex 3? ICI Global supports the proposal to allow a CCP to offer accounts with an MPOR of one business day for financial instruments other than OTC derivatives. We agree that CCPs should be permitted to offer these accounts as individually segregated accounts or as omnibus accounts where margin is calculated on a gross basis. The proposal would promote the harmonization of global derivatives regulation and facilitate cross-border transactions, i.e., transactions between U.S. and EU counterparties, by increasing the likelihood that U.S. and EU regulators will recognize each other's clearing regimes as equivalent. Absent a finding of equivalence, market participants could be precluded from engaging in cross-border transactions subject to clearing mandates in the U.S. and the EU because these transactions could not comply with applicable rules in both jurisdictions (i.e., cleared

through a CCP authorized or recognized under the laws of both jurisdictions). We also agree with ESMA's observation in paragraph 6 of the Consultation Paper that if the U.S. regulatory framework were considered equivalent to that of the EU despite the current differences in margin treatment, the higher cost of a net margin regime could encourage EU clients to clear with U.S. CCPs instead of using EU CCPs. Moreover, the proposal would offer a high level of protection to client margin held in gross omnibus accounts. For example, gross margining mitigates fraud risk by reducing the amount of margin held by clearing members (and susceptible to fraud). Under gross margining, clearing members must pass to the CCP enough margin to cover 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. Consequently, under a gross margining regime, more customer collateral is held with the CCP and therefore protected from the risk of fraud by the clearing member. The draft RTS also afford clients certain protections in the event that their clearing member defaults by requiring a CCP to know the identity of any client who avails itself of the option to use an account with a one business day MPOR. This proposal, in the context of a gross margining regime, could facilitate porting of client positions by ensuring that all clients are fully margined at the CCP and the CCP knows the identity of each client and the amount of collateral that belongs to each client. Having sufficient collateral identified with each individual client would facilitate the transfer of client positions and associated collateral to a back-up clearing member. If a CCP ultimately has to liquidate a client's position, the draft RTS also would facilitate the return of the client's collateral. Article 48(7) of EMIR provides that "any balance owed by the CCP after the completion of the clearing member's default management process by the CCP shall be readily returned to those clients when they are known to the CCP, or, if they are not, to the clearing member for the account of its clients" (emphasis added). Together with Article 48(7), the draft RTS would facilitate the return of client margin held in gross omnibus accounts in the event of a clearing member default. 6 <

ESMA_QUESTION_REVIEW_OF_MPOR_1> Do you agree that intraday margins should be called when the variation when the new margin requirement is higher than 120% of the updated available collateral, unless the margin call is not material on the basis of predefined thresholds defined by the CCP? Please provide quantitative data on the potential costs that this condition will imply and the reasons for those. The draft RTS would require CCPs that offer one day MPOR gross margining accounts to implement new procedures for calculating and calling margin for these accounts. Specifically, the draft RTS would require a CCP to implement "procedures to calculate for each account initial and variation margin requirements at least every one hour during the day" and to collect margin "within one hour where the new margin requirement is higher than 120% of the updated available collateral," unless the margin call is not material on the basis of predefined thresholds defined by the CCP. Although ICI Global appreciates that a CCP should collect adequate margin to protect itself from the exposure resulting from the positions of its clearing members and their clients, the proposed requirement to collect additional margin on an hourly basis is operationally burdensome and infeasible, at least for some market participants. As a result, this proposed requirement may effectively eliminate one day MPOR gross margining accounts as a viable alternative. Moreover, hourly transfers of margin would significantly increase operational risk. Currently, U.S. law requires CCPs to call variation margin for derivatives at least once each business day and grants CCPs the authority to call margin on an intraday basis, either routinely, when thresholds specified by the CCP are breached, or in times of extreme market volatility. We believe a similar approach for EU CCPs would increase the consistency of global derivatives rules while also being more responsive to actual risks faced by these CCPs, including risks materializing

quickly, than the rigid hour-by-hour approach of the draft RTS.

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