EACH response to the ESMA discussion paper 2015/1295 on Article 26 of the EMIR RTS 153/2013

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1. Introduction

The European Association of CCP Clearing Houses (EACH) represents the interests of Central Counterparties (CCPs) in Europe since 1992. EACH currently has 20 members from 16 different European countries and is registered in the European Union Transparency Register with number 36897011311-96.

EACH welcomes the opportunity to provide input to the ESMA discussion paper 2015/1295 on Article 26 of the EMIR RTS 153/2013.

2. EACH response

EACH welcomes ESMA's proposal to allow CCPs authorised under EMIR to follow a policy of gross collection and posting of client margin. As ESMA notes, a policy of gross collection and posting of client margin to the CCP increases the amount of customer collateral at a CCP to address a default event in most cases, even where a higher liquidation period is used as part of a net margining regime. Increased client margin at the CCP has a number of risk benefits including a reduction in the likelihood that one client's margin will be used to cover the losses of another client in a default event since each client will be fully margined at the CCP level. In addition, client gross margin collection and posting results in a reduction in systemic risk by significantly improving client portability (compared to liquidation) by allowing for full margin porting of clients by a CCP to multiple different non-defaulting clearing members and in turn reducing the chances that client positions will have to be liquidated which would exacerbate volatility in stress conditions associated with a clearing member default.

Please note that one EACH member does not support the remainder of this response.

However, it should be noted that the net account structure model has the benefit of reducing the liquidity pressure on the clearing member.

Porting of client’s positions and assets is a key aspect of EMIR. Gross OSAs structure could increase the likelihood of porting. However the success of porting is directly linked to the quality of data available to the CCP in respect of the identity of the client. If the identity of the client remains unknown to the CCP, the CCP will be unable to contact to client to assess the choice of transferee clearing member. There should be obligations on both the member and the client to provide up to date data to the CCP on the identity of the client to enable porting.

In terms of the time horizon for the liquidation period, EACH considers a 2 day holding period to be prudent and appropriate, however EACH also considers that a 1 day holding period can be sufficiently prudent and appropriate where it generates initial margin requirements sufficient to cover the CCP's potential future exposures to clients based on price movements in the interval between the last collection of variation margin and the time within which the CCP estimates that it would be able to liquidate a client's positions.

Please note that two EACH members do not support the following section of this response.

If the option of a time horizon for the liquidation period shorter than the current EMIR 2-day standard is made available to CCPs authorised under EMIR, it is all the more important that a CCP seeking to avail its use comply with the existing risk management requirements set out in EMIR. In particular, regarding:

1) The ability to call and collect margins on an intraday basis;
2) The ability to demonstrate, both based on historical experience, ongoing firedrills, and through evaluating product and position liquidity as well as market structure, that the holding period remains prudent;
3) That porting arrangements are operationally and legally robust and of the same likelihood as those achieved with the current 2 day minimum holding period. The greater facility of porting individually segregated accounts should be reflected in the optionality of a shorter holding period, provided that such assurances can be demonstrated for them. Any time horizon for the liquidation period needs to be in line with the current EMIR provisions with regard to client data collection.
4) Regulatory requirements on member and client to provide details on the entity of the client to the CCP for the purpose of porting.

If ESMA finally decides to amend article 26 of the EMIR RTS 153/2013, EACH would strongly support that CPMI-IOSCO urgently update the Principles for Financial Market Infrastructures accordingly in order to provide certainty and ensure a level field in jurisdictions across the world. Although margin standards for cleared CCP derivatives under EMIR and comparable legislation in other jurisdictions, such as the US Dodd-Frank are consistent with the PFMIs, they are not identical. Prudential rules (i.e. provisions on margin standards) in different jurisdictions may not satisfy an equivalence test if judged on a line-by-line basis. Thus, it is important to take a holistic, outcomes-based approach to assessing equivalence of margin standards to avoid weaker margin coverage for the CCP from clearing participants and end customers. Weaker coverage could result in margin arbitrage for identical products offered by CCPs which offer cross-border services and potentially result in a flow of business currently cleared in one jurisdiction to other jurisdictions. This can be avoided through the authorisation of CCPs from jurisdictions that have equivalent margin standards. The net result of a lack of harmonised international margin requirements would be to encourage the precise type of margin arbitrage that prudent regulators and clearing house operators have long and appropriately avoided.

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