esma European Securities and Markets Authority

Reply form for the Discussion Paper on Review of Article 26 of RTS 153/2013

26 August 2015

European Securities and Markets Authority

Date: 26 August 2015

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA Discussion Paper on Review of Article 26 of RTS 153/2013, 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 <ESMA_ QUESTION_RTS_153_26_1> - 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_ RTS_153_26_NAMEOFCOMPANY_NAMEOFDOCUMENT.

E.g. if the respondent were XXXX, the name of the reply form would be:

ESMA_RTS_153_26_XXXX_REPLYFORM or

ESMA_RTS_153_26_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 us by **30 September 2015.**

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input/Consultations'.

Publication of responses

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that 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 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 headings 'Legal notice' and 'Data protection'.

Introduction

Please make your introductory comments below, if any:

< ESMA_COMMENT_RTS_153_26_1>

Eurex Clearing welcomes ESMA's efforts to find a basis for equivalence between U.S. and the European CCP regulation. Eurex Clearing is committed to prudent standards for risk management, and their equal implementation across jurisdictions, and urges regulators and policy makers to advocate for such changes in a holistic way through global bodies, notably CPMI/IOSCO. In that respect the two aspects of the current discussion "margin period of risk" (MPOR) and segregation models should be assessed separately.

The MPOR should be based on prudent assumptions for the default management process and porting, hence should clearly determine the time necessary to port or liquidate positions preventing additional market turbulences and protecting financial stability.

In Eurex Clearing's view, a two day holding period as currently defined in Art. 26 RTS 153/2103 is an adequate minimum standard.

We would like to note that the consulted change can create two unintended effects. Firstly, it will create an un-level playing field for margin collection: the proprietary accounts of Clearing Members will be relatively more expensive at a CCP offering services at the proposed minimum standards. This will create a risk of regulatory arbitrage and could lead to Clearing Members preferring to move their own positions into "client" accounts, or to cease being Clearing Members altogether. Secondly, ceteris paribus, the proposal in the discussion paper reduces the amount of margin a Clearing Member has available to liquidate a defaulting client.

Any reduction in these standards should be optional only, and the possibility of their use by a CCP must be based on conditions to ensure that the lower periods are commensurate with both risk management and protection of both the direct and indirect participant. The use of a possible lower standard should also be considered in terms of the incentives it sets. Accounts, such as individual segregated accounts for clients, which offer a by far greater security and likelihood of porting as omnibus segregated accounts should not be penalised but rather included in such lower treatment based on the same requirements of demonstration.

Eurex Clearing has no objection to a gross model of margin collection. Eurex Clearing maintains all disclosed clients (Exchange Members/ Non-Clearing Members and Registered Customers) on a gross margin model already even if they are in an omnibus segregated account.

In addition, the U.S. and the EU regime, differ not only in the concrete CCP requirements, but also in their insolvency laws and practice. These differences impact the direct CCP supervision and need to be considered when proposing changes to EMIR and the relevant RTS in order to deem both regulations equivalent.

In the U.S., a bankruptcy trustee of an insolvent Futures Commission Merchant acting as a Clearing Member (FCM Clearing Member) has by law comprehensive instruments. The bankruptcy trustee may for example force clients of an insolvent FCM Clearing Member who opted for porting to be ported to another FCM Clearing Member as replacement Clearing Member which is determined by the bankruptcy trustee of the insolvent FCM Clearing Member, irrespective of any choice made by the affected clients[1].
In the EU, different national insolvency regimes exist and the various laws in the different European Member States do not provide insolvency administrators with such comprehensive authority. Rather, porting in Europe depends on the cooperation between CCPs, affected clients and the replacement Clearing Members on a rather voluntary basis. Clients cannot be forced to be ported to a specific Clearing Member and replacement Clearing Members cannot be forced to take over affected clients. The likelihood of porting

[1] Subchapter IV of chapter 7 of the U.S. Bankruptcy Code, 11 U.S.C. § 101 et seq., and §§ 766(c)and (h) of the U.S. Bankruptcy Code

rather depends on the chosen segregation model and the cooperation between CCP, affected clients and non-defaulted Clearing Members.

Simply adopting the U.S. 1-day regime without making the necessary amendments to the European insolvency laws may have unintended consequences on the market stability when it comes to Clearing Member defaults. Without these changes or others which achieve similar objectives, CCPs offering clearing services to European Clearing Members should in general be required to apply a minimum liquidation period of two days.

The aspect that an omnibus account is gross or net margined does not indicate whether the likelihood of porting will be higher or lower or whether the length of the default management process will be longer or shorter. An omnibus gross margined account may not be liquidated or ported faster than an omnibus net margined account due to operational burdens and the necessary alignment between affected clients amongst each other and potential replacement Clearing Members. Only through individual segregated accounts the highest protection of customers is achieved due to the segregation from the defaulting Clearing Member as well as other clients. The likelihood of porting is much higher and can be achieved much faster as fewer decision-makers are involved in the porting process. As a result, if a decrease of the minimum liquidation period from 2 to 1-day for listed business is still considered, it should be linked to the likelihood of porting and the time required for the default management process and not to the fact that a client account is gross or net margined. Therefore, a reduction of MPOR should only be considered for individual segregated accounts to incentivize and promote customer protection in Europe.
< ESMA_COMMENT_ RTS_153_26_1>

Q1. ESMA welcomes views on the assumption that client margins maintained at CCP level on a 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 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 RTS are not changed and the impact for the whole system if the MPOR at CCP level is reduced.

<ESMA_QUESTION_RTS_153_26_1>
Firstly, Eurex Clearing would like to note that in Europe Clearing Members in general collect gross margin from their clients based on a minimum liquidation period of 2 days. In Eurex Clearing's case disclosed clients and registered customers are treated on a 2-day gross basis already. Eurex Clearing's Clearing Members are collecting margin requirements for undisclosed clients on a gross basis however in general only the net margin is forwarded to the CCP with the remaining margin staying at the Clearing Members. Hence, in general terms the current regime may result in a situation where an EU CCP has less client margin on its books under a 2-day net regime than U.S. CCPs under a 1-day gross regime, while in total the European regime collects higher client margin resulting in better systemic stability than in the U.S.

Secondly, it should be noted that under the U.S. regime, irrespective of whether an insolvency related or a non-insolvency related termination event with respect to a Clearing Member has occurred, affected clients which opt for porting will generally not be transferred with their complete collateral delivered to the CCP. In a non-insolvency related termination event, CCPs are by law not allowed to port more collateral per client as the "funded balance" as defined by CFTC rule 190.07(c). In case of the occurrence of an insolvency-related termination event it will be the sole discretion of the insolvent Clearing Members bankruptcy trustee to determine the amount of client margin a CCP is allowed to port. This in turn means that porting in the U.S. will always require some kind of double funding with respect to collateral to be delivered to the replacement Clearing Member by the ported clients. This may cause unintended destabilizing effects, especially during market turmoil's and leaves clients with fellow customer risk. If porting takes place in Europe all collateral delivered to the CCP with respect to a particular collateral pool (either OSA or ISA) will be ported together with the related positions. Thus sufficient margin is in every case ported to cover the related positions.

Thirdly, it is highlighted in the ESMA discussion paper that for Clearing Members proprietary accounts a reduction of the minimum liquidation period to one day is not feasible due to several reasons, leaving the most important concern on regulatory arbitrage unchanged. Given this uneven playing field for house accounts, but the objective to allow for equivalence to align closer to the U.S. regime by proposing to reduce the minimum liquidation period to 1-day for gross margined client accounts, we trust that such change will, if at all, only be implemented, if the CFTC increases the minimum liquidation period for house accounts to two days.
. <ESMA_QUESTION_RTS_153_26_1>

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

<ESMA_QUESTION_RTS_153_26_2>

Eurex Clearing is of the opinion that the comingling of liquidation period and the segregation model to be applied adds further room for regulatory arbitrage, complexity and most likely further legal uncertainty to the segregation model landscape in Europe. Eurex Clearing doubts that a further differentiation of financial instruments other than derivatives (e.g. cash instruments etc.) adds value and increases safety. Thus, the applied liquidation period should stay equal for financial instruments other than non-OTC derivative products.
<ESMA_QUESTION_RTS_153_26_2>

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.

<ESMA_QUESTION_RTS_153_26_3>
We understand from the discussion paper that ESMA's goal is to achieve equivalence with the CFTC CCP regime. Under the CFTC rules, a minimum liquidation period for swaps of five days is required which is already in line with EU requirements. Furthermore, a 5-day liquidation period as minimum requirement for OTC Derivatives is a prudent and conservative and appropriate measure. Eurex Clearing wants to highlight that Art 26 (2) of RTS (EU) No 153/2013 already requires that the liquidation period should be linked to the default management process and the time required for porting, whereas Art. 26 (1) of RTS (EU) No 153/2013 establishes minimum requirements. Together these requirements establish a consistent framework for determining appropriate liquidation periods. If there are any OTC derivatives for which a minimum 5-day liquidation period would be inappropriate, this will be accounted for in this framework)
<ESMA_QUESTION_RTS_153_26_3>

Q4. Should ISA and gross OSA be treated equally in terms of MPOR? Please provide quantitative evidence to support your arguments.

<ESMA_QUESTION_RTS_153_26_4>
EMIR has introduced two basic choices of client asset segregation: omnibus segregated accounts and individual segregated accounts to ensure a high level of customer protection. The most important and reliable aspect to consider is the choice of segregation models under EMIR. Whereas individual segregated accounts provide for the highest customer protection, omnibus gross segregated accounts suffer from operational burdens resulting in a reduced likelihood of porting and longer default management process when compared with individual segregated accounts.

Thus, if a reduction of the minimum liquidation period for financial instruments other than OTC derivatives to one day is considered, this should be limited to individual segregated accounts.

Comparison of segregation models focussing on protection level, margin location and likelihood of porting

	Individual Segregated Accounts	Gross Omnibus Segregated Accounts
Protection Level	Segregation of client's positions & collateral from Clearing Members and other clients positions & collateral ⇨ Client has NO fellow customer risk	Segregation of clients positions & collateral from Clearing Members positions & collateral ⇨ Clients have fellow customer risk
Margin location	Margin of each client is held in an individual segregated account at the CCP	Margin of all clients is comingled in a segregated account at the CCP
Likelihood of Porting	Highest porting likelihood since only the individually segregated client, the defaulting Clearing Member, the replacement Clearing Member and the CCP need to be involved and	Lower porting likelihood since all clients in the omnibus account, the defaulting Clearing Member, the replacement Clearing Member and the CCP need to be involved and decide

	decide on porting solution	on porting solution

Individual segregated accounts and – as outlined above – already many omnibus segregated accounts are gross margined in Europe on a 2-day basis. Hence, they can be considered as equal in terms of MPOR. However, if it comes to a Clearing Member default one should consider carefully the aim and protection capabilities of the different models.

The goal of omnibus segregated accounts is to segregate clients' positions and assets from their Clearing Member's positions and assets, i.e. protection of clients' from the Clearing Member's. However, in omnibus segregated accounts, clients are not segregated/ protected from each other. At a maximum, subgroups of clients can be created. Therefore, clients bear fellow client risk within omnibus models.

As clients are grouped together, in the event of a default, all clients in the same omnibus account, even if they are gross-margined, must make unanimous decisions with regards to porting, i.e. all positions and collateral for those positions of a particular omnibus account must port to the same Clearing Member. As a result, finding consensus within a relatively short period of time amongst a group of omnibus clients is challenging, in particular if no decisions were prepared in advance, if there are a large number of clients in an omnibus account or if any clients in the omnibus account are unknown to the rest of the group.

The goal of individual segregated accounts is to segregate the client's positions and collateral from its Clearing Member's as well as all other client's positions and collateral. As the client is segregated/ protected from all other clients of the Clearing Member and the Clearing Member itself, it bears no fellow client risk. Any shortfall in collateral to cover the margin requirement will not be proportionally shared with any other clients.

As the client is segregated from all other clients it can make decisions with regards to porting by itself. This ability is more likely in a shorter period of time.
<ESMA_QUESTION_RTS_153_26_4>

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?

<ESMA_QUESTION_RTS_153_26_5>
Intraday margin call frequency must in general be higher if the CCPs MPOR/buffer is shorter. To prevent substantial shortfalls, a maximum of one hour based on strict thresholds should apply for holding periods of one day. This requires that CCPs should demonstrate to the authorities both the ability to compute margins in real or near time, as well as the operational processes for collecting margin.

A further condition to be considered should be if the segregation model offers the option for clients to make direct margin payments to the CCP in case of a Clearing Member default to prolong the porting period.
<ESMA_QUESTION_RTS_153_26_5>

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?

<ESMA_QUESTION_RTS_153_26_6>

As stated in the discussion paper the treatment of house accounts shall remain with 2-day gross. Affiliates of Clearing Members are treated as clients in the EU and thus are not assigned to the Clearing Members proprietary account. Hence, requiring a minimum liquidation period of two days for a Clearing Member's affiliate could be achieved by either segregating affiliates from non-affiliates clients through individual segregation of the affiliates or assigning all affiliates to one segregated omnibus account.

Individual segregation allows for the highest customer protection. Thus there would be no particular reason why individual segregated affiliates should not benefit from a reduced liquidation period, if introduced. Omnibus segregation in general should not qualify for a reduction of the liquidation period given the reasons provided in the response to Q.4. Thus the pure fact that an entity is an affiliate should not influence the liquidation period.
<ESMA_QUESTION_RTS_153_26_6>

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?

<ESMA_QUESTION_RTS_153_26_7>
Porting arrangements should be operationally and legally robust and of the same likelihood as those achieved with the current two day minimum period. The greater facility of porting under individual segregated accounts should be reflected in the conditions of a shorter holding period. A back-up Clearing Member or the option to make direct margin payments to the CCP could support such arrangements.
<ESMA_QUESTION_RTS_153_26_7>

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

<ESMA_QUESTION_RTS_153_26_8>
If a 1-day holding period is allowed, then in addition to the aforementioned conditions on intraday margining and likelihood of successful porting, ESMA should carefully ensure that CCPs seeking to make use of a shorter holding period can prove that this is sufficient for the default management of the positions.
<ESMA_QUESTION_RTS_153_26_8>