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Additional Information

Level 1 Regulation
Regulation 648/2012 - OTC derivatives, central counterparties and trade repositories (EMIR) - CCPs

Level 2 Regulation
COMMISSION DELEGATED REGULATION (EU) No 153/2013 Regulatory technical standards on requirements for central counterparties

Topic
Other issues (CCP)

Additional Legal Reference
Article 39 of EMIR - old CCP question 8 dated 31/03/2015

Subject Matter

Segregation and portability (old CCP question 8 dated 31/03/2015)

Question

Article 39(3) of EMIR states that: “A CCP shall offer to keep separate records and accounts enabling each clearing member to distinguish in accounts with the CCP the assets and positions held for the account of a client from those held for the account of other clients (‘individual client segregation’)”. Article 39(10) of EMIR states that “Assets refer to collateral held to cover positions and include the right to the transfer of assets equivalent to that collateral or the proceeds of the realisation of any collateral...”.

(a) Under Article 39(6) of EMIR, what is the definition of client requirement and excess margin? Will clearing members be obliged to post this margin directly at the CCP? Additionally, how should a clearing member allocate excess margin over various CCPs it is linked to?

(b) Does EMIR allow CCPs to offer unsegregated accounts in which the assets and positions of clearing members are not segregated from those held for the accounts of the clearing member's clients?

(c) At what time do clearing members have to comply with requirements on segregation and portability under Article 39 of EMIR?

(d) May a CCP meet the requirements of Article 39(3) of EMIR by identifying only the value of collateral due to a client; or is it necessary to identify the specific assets due to a client?

(e) Under Article 39(3) of EMIR, the requirement for individual segregation is a requirement that the CCP offer to keep separate records and accounts enabling each clearing member to distinguish in accounts with the CCP, the assets and positions held for the account of a client from those held for the account of other clients. Does individual client segregation require:

1. That assets be segregated at the level of the security settlement system (for financial instruments) or at the level of the central bank (for cash) or at the level of the authorised financial institution (where alternative highly secured arrangements are permitted)?
2. That payments associated with the positions of an individually segregated client (i.e. variation margin payments, premium payments, etc.) be recorded in the separate records and accounts maintained for the individually segregated client at the CCP?

(f) Article 39.9(c) of EMIR provides that assets covering the positions recorded in an account shall
not be exposed to losses connected to positions recorded in another account.

1.Can a CCP apply surpluses in a clearing member’s house account to an omnibus client account or an individually segregated client account?
2. Can a CCP, with a clearing member’s permission, use the clearing member’s own assets

(i.e. assets that were not posted by a client of the clearing member) to support the registration of client trades?

(g) Are CCPs expected to allow each clearing member to operate more than one house or omnibus client account under Article 39 of EMIR?

(h) Are CCPs required to provide segregated accounts for indirect clients?

(i) Are non-EU clearing members of EU CCPs providing services to clients subject to the segregation requirements in Article 39?

(j) Are EU clearing members of non-EU CCPs required to comply with Article 39 when offering client clearing on non-EU CCPs?

(k) Under Article 39(6) of EMIR, are clearing members obliged to post excess margin directly at the CCP if the collateral provided by the client is not eligible at the CCP? What if the margins collected by clients are in the form of a bank guarantee in favour of the clearing member?

(l) Can a CCP have a provision in its rules and/or operating procedures under which the CCP can, if so requested by a clearing member, transfer the positions and assets held for the account of a defaulted client of that clearing member from the segregated account holding those positions and assets into the house account of the clearing member to facilitate the management of the client default by the clearing member?

(m) Can a participant of a trading venue which is also a clearing member of the relevant CCP deny its clients the protections established under Article 39 of EMIR where it executes trades on behalf of its clients and subsequently clears those trades with the relevant CCP?

(n) If a CCP automatically pays variation margins in respect of an individually segregated client account to the clearing member each day (auto repay), is the clearing member required to return the collateral to the client?

ESMA Answer

31-03-2015

Original language

(a) The terms ‘client requirement’ and ‘excess margin’ are not defined in EMIR. However, Article 39(6) of EMIR is clear that for individually segregated clients, any margin called from a client, which is over and above the amount called by the CCP to cover the positions of that client, must be posted to the CCP. The current practice of clearing members calling excess margin and retaining it is not permitted under EMIR for clients opting for individual segregation. Where a clearing member has collected additional margin in respect of particular client positions that has opted for individual client segregation, the excess margin should be passed to the CCP that clears those positions.

In the case where the relevant positions are with multiple CCPs, clearing members should ensure that the approach taken is made transparent to clients and where the clients opted for individual segregation, they will need to agree on the allocation of the excess margins to the different CCPs.

In the case where an individually segregated client has provided some assets to the clearing member that are not related to clearing activities at the CCP, then those assets do not have to be posted to the CCP if:

- the clearing member and the client have contractually agreed so in advance, and

- the assets are not dedicated to cover the current positions with the CCP and are clearly identified as such.

The two conditions above should be supported by appropriate documentation.

(b) No, EMIR does not allow the use of unsegregated accounts. Article 39(2) and 39(3) of EMIR provide that CCPs must offer both 'individual client segregation' and 'omnibus client segregation' (these terms being defined in Articles 39(2) and 39(3) of EMIR). While CCPs might offer other levels of protection in addition to individual client segregation and omnibus client segregation (e.g. an omnibus gross margin client model), omnibus client segregation is the minimum level of client protection that can be used under EMIR.

This is because Article 39(4) of EMIR requires that a clearing member distinguish, in accounts with the CCP, the clearing member's own assets and positions from those assets and positions held for the accounts of the clearing member's clients. Article 39(9) of EMIR

includes further criteria which must be met by the accounts held by a clearing member with a CCP. These provisions are not compatible with the use of unsegregated accounts.

(c) The requirements on clearing members that are established in EMIR (e.g. those in Articles 38 and 39 of EMIR) apply to clearing members of all CCPs established in the European Union. These obligations therefore come into force at and should be met by the time that the CCP is authorised under EMIR.

(d) In the case of a default of a clearing member, Article 48(6) of EMIR requires that a CCP's model of individual segregation provides for the transfer of the assets and positions held for the account of an individually segregated client to another clearing member or provides for the CCP to actively manage its risks in relation to those positions, including liquidating the assets and positions. Where the transfer of the assets and positions held for the account of an individually segregated client to another clearing member does not take place then, pursuant to Article 39(9) of EMIR, the CCP's model of individual segregation should ensure that the assets recorded in the individually segregated account are not exposed to losses connected to positions recorded in another account. Accordingly it is not sufficient that the account at the CCP identifies only the value due to the account of the client. It must identify the specific assets (e.g. the particular or equivalent securities) due to the account of the client.

Alternative approaches to segregation that identify only the value due to the accounts of the clients (while recording the assets provided for the account overall) may be offered in addition, provided they meet the relevant requirements of Article 39 of EMIR, but they do not meet the requirement to offer individual client segregation.

(e)(1) Individual segregation within the meaning of Article 39(3) of EMIR applies to assets and positions held at CCP level. Hence, individual segregation does not have to be necessarily reflected at the level of the security settlement system, central bank or alternative highly secured arrangements with authorised financial institutions. However, it should be noted that Article 47(5) requires that assets belonging to the CCP should be distinguished from assets belonging to clearing members when deposited with a third party.

(e)(2) Article 14(3) of Commission Delegated Regulation (EU) No 153/2013 (RTS on CCPs) requires that a CCP shall make, and keep updated, a record of the amounts of margins called by the CCP and the corresponding amount actually posted by the clearing member with respect to each individually segregated client account. Variation margin payments, representing amounts of margins called by the CCP are therefore required to be recorded in the separate records and accounts maintained for the individually segregated client at the CCP. However, this requirement does not imply that payment instructions must be made for every individually segregated account separately. CCPs may therefore issue one payment instruction for multiple accounts at the same time, so long as they issue separate margin calls for each account (house, omnibus client, individually segregated client account) and correctly record these margin calls, and the payments which correspond to them, in the records of each account.

(f)(1) The objective of the provisions in Article 39 of EMIR is to ensure that clients of clearing members are granted a high level of protection (see Recital 64 of EMIR) . Furthermore, Article 45 of EMIR provides that a CCP shall use the margins posted by a defaulting clearing member prior to other financial resources when covering losses.

CCPs are therefore permitted to have rules and procedures which facilitate the use of surplus margin on a defaulted clearing member’s house account (that would otherwise have been payable by the CCP to the estate of the clearing member) to meet any obligation of the clearing member in respect of losses on a client account of that clearing member.

For the avoidance of doubt, surplus margin on a client account of a defaulted clearing member cannot be used to meet any losses on the defaulted clearing member’s house account(s).

(f)(2) Articles 39(4) and 39(9)(a) of EMIR require that clearing members distinguish their own assets in separate accounts at the CCP from those assets held for the account of their clients.

Where a clearing member desires to use its own assets (i.e. assets that were not posted by a client of the clearing member) to fulfil the margin requirements of the client account, then such assets could be recorded in a client account at a CCP, however in doing so the assets would be treated as assets held for the account of clients of the clearing member. This would mean that upon a default of the clearing member, the assets would be exposed to losses connected to the client account in which the assets were recorded and could no longer be used to meet any losses on the defaulted clearing member's house account(s).

(g) Article 39(2) of EMIR requires CCPs to offer to keep separate records and accounts (in the plural) enabling each clearing member to distinguish in accounts (in the plural) with the CCP the assets and positions of the clearing member from those held for the account of its clients ('omnibus client segregation'). Article 39(3) of EMIR requires that upon request CCPs shall offer clearing members the possibility to open more accounts in their own name or for the account of their clients. CCPs are therefore expected to offer clearing members the possibility to open more than one omnibus client account, when requested to do so.

(h) Article 3(1) of RTS 149/2013 (RTS on OTC derivatives) requires a CCP to set up, on the request of a clearing member, accounts to enable the assets and positions of the client to be recorded separately from the assets and positions of the indirect clients of the client. Accordingly, at the request of a clearing member, the CCP must, at a minimum, set up an omnibus segregated account in which only the positions and assets of the indirect clients of a client may be recorded. The CCP may also, at the request of a clearing member, set up individually segregated accounts in which the positions and assets of indirect clients of a client may be recorded, but there is no obligation to do so.

(i) Under Article 39(5), clearing members must offer their clients, at least, the choice between omnibus client segregation and individual client segregation and inform them of the costs and level of protection associated with each option. The references to clearing members in Article 39 are not limited to EU clearing members, so all clearing members of EU CCPs are required to comply. Similarly, the references to clients in Article 39 are not limited to EU clients. CCPs are expected to require all clearing members to comply with the relevant EMIR provisions

through their rules.

In the case that a third country insolvency regime applicable to a clearing member could interfere with the provision of omnibus client segregation or individual client segregation, including intrinsic client protections, in the manner set out in Articles 39 and 48, the clearing member should offer its clients alternative possibilities that ensure those clients receive, at least, the choice of omnibus client segregation and individual client segregation. Alternative possibilities may include clearing solutions provided by an affiliate or other clearing member of the CCP.

When, notwithstanding the alternatives offered, the client chooses to use the third country clearing member and risks remain due to the third country insolvency regime, the clearing member must disclose those risks in full to the client at the outset of the relationship, in accordance with both Articles 39(5) and 39(7)).

(j) No but EU clearing members will only be allowed to be a clearing members of a non-EU CCP which has been recognised as meeting equivalent requirements to EMIR under the process set out in Article 25. This will include an assessment of the CCP's segregation arrangements.

(k) Where a client that has opted for individual client segregation provides a clearing member with additional margin which is not eligible collateral at the CCP, then the clearing member does not have an obligation to transform such additional margin into eligible collateral. The CCP has no obligation to accommodate this collateral however the clearing member should pass such additional margin to the CCP if the latter has the operational and technical means to receive it. However, under no circumstances would such additional margin be eligible to meet margin calls made by the CCP.

Where the collateral provided by the client is a bank guarantee in favour of the clearing member then the clearing member is not required to post to the CCP an amount of eligible collateral equal to the value of the bank guarantee that exceeds the margin called from the client by the clearing member.

(l) It is the responsibility of the clearing member to inform the CCP of the account to which positions and assets held by the clearing member should be allocated. The contractual arrangement between a clearing member and its client may provide for the positions and assets held for the account of the client to be transferred to the house or proprietary account of the clearing member in the event of a default of the client. Accordingly, there should be no restriction on the ability of a CCP to transfer the positions and assets held for the account of a defaulted client into the house account of the clearing member on instruction of that clearing member, subject to that clearing member not being in default itself and in accordance with any applicable valuation and other rules and/or operating procedures of the CCP. This existence of such a process should be clearly disclosed by CCPs and clearing members; for example, as required by Article 39(7) of EMIR and would need to be compatible with the applicable insolvency law.

(m) No, even if the client does not have an explicit contractual relationship covering the clearing of these trades. Article 2(1)(15) of EMIR provides that a ‘client’ is “an undertaking with a contractual relationship with a clearing member of a CCP which enables that undertaking to clear its transactions with that CCP”. Given that the trade is cleared by a CCP, then the contractual relationship entered into by the client enables the clearing of the transaction with the CCP. Therefore, even if the contractual arrangement governing the provision of trading services does not explicitly cover the provision of clearing services by the firm executing the trade on behalf of its client, the latter should be considered a client under EMIR and should benefit from the client protections established therein.

(n) According to article 39(6) of EMIR, when a client opts for individual segregation any margin in excess of the client’s requirement shall be posted to the CCP. As such, any excess collateral allocated to an individually segregated account must either be maintained at the CCP in accordance with article 39(6) or returned to the client. CCPs should offer clearing members the possibility of holding excess margin allocated to an individually segregated account at the CCP in that account (i.e. switching off auto repay), provided that the CCP can hold the currency in which the cash variation margin is denominated overnight in compliance with the CCP’s investment policy.

When variation margins are denominated in currencies that the CCP cannot hold overnight (e.g. because it has no overnight investment facilities for such currencies - typically, currencies not accepted for initial margins), consistent with CCP answer 8k, the CCP has no obligation to accommodate these currencies and the clearing member is required to return the collateral to the client, unless the latter , via a documented request, instructed the clearing member to hold the client’s repaid variation margins in a non-clearing account meeting the conditions in answer 8a.