



MANAGED FUNDS
ASSOCIATION

EUROPEAN SECURITIES AND MARKETS AUTHORITY
103 Rue de Grenelle
Paris
75007
France

1 February 2016

Dear Sirs,

**Joint Response to ESMA Consultation Paper on the Review of Article 26 of RTS No 153/2013
with respect to MPOR for client accounts**

The Alternative Investment Management Association (AIMA)¹ and Managed Funds Association (MFA)² (together, we) are grateful for the opportunity to respond to the European Securities and Markets Authority (ESMA) 'Consultation Paper on the Review of Article 26 of RTS No. 153/2013 with respect to MPOR for client accounts' (Consultation Paper).³ This joint response is a follow up to, and consistent with, our Joint Response to the ESMA 'Discussion Paper on the Review of Article 26 of RTS No. 153/2013 with respect to client accounts' (Discussion Paper),⁴ published in August 2015 (Joint Response).⁵

We praise ESMA for its prompt and thorough review of the responses it received to the Discussion Paper, and the degree to which ESMA has taken account of industry feedback in developing the Consultation Paper. For example, we strongly support ESMA's decision not to require market participants to maintain a pre-existing arrangement with a back-up clearing member (CM).⁶

We also laud ESMA's decision to publish the draft regulatory technical standards (RTS) amending Article 26 of RTS No.153/2013 with respect to the margin period of risk (MPOR) for client accounts for non-OTC derivatives 'to ensure a level playing field with other jurisdictions.'⁷ Both AIMA's and MFA's members support the development of well formulated and globally consistent regulation, which is particularly important for the derivatives markets due to their truly global nature. Thus, we generally support the substance of the draft RTS, which we believe reflects a fair and balanced

¹ Founded in 1990, the Alternative Investment Management Association (AIMA) represents the global hedge fund industry. Our membership is corporate and comprises over 1,600 firms (with over 10,000 individual contacts) in more than 50 countries. Members include hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors. AIMA's manager members collectively manage more than \$1.5 trillion in assets. See www.aima.org.

² Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

³ Available at: <https://www.esma.europa.eu/press-news/consultations/consultation-paper-review-article-26-rts-no-1532013-respect-mpor-client>

⁴ Available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-1295_dp_on_review_of_article_26_of_rts_153-2013.pdf

⁵ Available online at: https://www.esma.europa.eu/file/13111/download?token=cdR_JHBX

⁶ See Consultation Paper at 5.

⁷ *Id.*

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approach to addressing potential impediments to EU recognition of US central counterparties (CCPs) and *vice versa*.

Need for prompt mutual recognition of US and EU CCPs

While we support the RTS and urge both ESMA and the European Commission (Commission) to continue to work to amend RTS No.153/2013 promptly to permit the use of one-day gross margining of non-OTC client accounts, we believe fundamentally that the key priority for the Commission and ESMA at this time should be ensuring the swift and reciprocal recognition of US CCPs and the determination of equivalence with respect to the US Commodity Futures Trading Commission's (CFTC) OTC derivative and exchange-traded derivatives (ETD) clearing rules. The importance of the Commission reaching a reciprocal agreement with the CFTC on these issues has become even more critical due to the:

- (1) Formal adoption by the Commission of its Delegated Regulation (EU) 2015/2205 containing final RTS for the mandatory central clearing of G4 currency OTC interest rate swaps (IRS),⁸ which entered into force on 21 December 2015, and which will enter into effect for the first category of counterparties on 21 June 2016, subject to frontloading which will *de facto* shorten this phase-in for certain IRSs to 21 February 2016;⁹ and
- (2) Impending clearing obligation for ETDs under Regulation (EU) No.600/2014 on markets in financial instruments (MiFIR),¹⁰ which currently is due to enter into effect on 3 January 2017.¹¹

We consider that it is vital to the ongoing liquidity of both ETD and OTC derivative markets that participants that transact on a cross-border basis have certainty that they will be subject to a single set of non-conflicting rules. We recognise, of course, that there are certain differences between the US and EU clearing and insolvency regimes, and that the draft RTS proposed within the Consultation Paper seeks to address one such difference. However, we believe that these differences are minor and should not form a barrier to US equivalence and *vice versa*. Rather, we consider that both EU and US rules appropriately and robustly implement the G20 commitments to make the derivatives markets safer and are compliant with the relevant IOSCO Principles for Financial Market Infrastructures.¹²

One-day gross margining

We are supportive of ESMA's proposal to allow CCPs to give a clearing customer using either an omnibus segregated account (OSA) with margins calculated on a *gross* basis (Gross OSA) or an individually segregated account (ISA), the option to margin its account based on either a: (1) two-day MPOR; or (2) one-day MPOR, if certain additional conditions are met.¹³ We also agree with ESMA's decision to require the use of a two-day MPOR for clearing customers using an omnibus account with margins calculated on a *net* basis (Net OSA).¹⁴ As we described in our Joint Response, a CCP would collect more margin under a one-day Gross OSA or ISA structure than under a two-day

⁸ See Commission Press Release on 'Financial stability: new Commission rules on central clearing for interest rate derivatives', dated 6 August 2015, available at: http://europa.eu/rapid/press-release_IP-15-5459_en.htm.

⁹ See final RTS for clearing of IRS published in the Official Journal of the European Union on 1 December 2015, available online at: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R2205&from=EN>.

¹⁰ Available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014R0600>.

¹¹ Without an agreement, a transaction between two in-scope counterparties located in the EU and the US would be forced irreconcilably to comply with both sets of rules. Of course, a contract can be cleared only in one jurisdiction and subject to one set of rules. It is vitally important that transactions between US and EU counterparties be cleared according to the most relevant rules to the particular contract.

¹² Available at: <http://www.bis.org/cpmi/publ/d101a.pdf>.

¹³ See Consultation Paper, 4.3 Annex 3, at 2, draft amended Article 26(2).

¹⁴ See *id.*



Net OSA structure where the CM's client book is of sufficient size that the netting effect between clients is efficient.¹⁵

As noted by ESMA, we agree that it is important that EMIR provides the optionality proposed by the draft RTS. Such would eliminate a critical difference between the EU and US regimes¹⁶ and help to foster globally consistent regulation of the derivatives markets.

Such global consistency is especially relevant for margin standards for cleared derivatives. The ability to employ a consistent methodology and process for margining of derivatives cleared in different jurisdictions globally would be especially beneficial for global investment fund managers seeking operational efficiencies when hedging and establishing directional positions, lowering costs, thus improving returns to end investors.

Calculation and collection of margin intraday

As we noted in our Joint Response, we recognise the risk mitigation value of requiring CCPs to perform intraday margin calculations and to make intraday margin calls.¹⁷ However, we continue to have concerns about making the intraday calling of margin a standard CCP practice.¹⁸ We would also fundamentally question whether the legal mandate to develop RTS contained under Article 41(5) of EMIR empowers ESMA to develop the additional obligations, as proposed, for intraday margin calculation and collection. We would suggest that the relevant Level 2 mandate is limited explicitly to ESMA developing RTS to specify the appropriate percentage and time horizons for the liquidation period, and the calculation of historical volatility, in order to ensure consistent application of Article 41.

From an operational standpoint, we believe that such margin calls are cumbersome on clients and would result in the less efficient use of assets, as clients would need to reserve additional assets to have assets available at all times to meet any such intraday margin calls. We, therefore, have concerns about proposed sub-paragraph (3)(c)(iv) of amended Article 26, which would require CCPs to calculate the margin for each client account using a one-day MPOR at least every hour during the trading day and to collect margin within one hour where the new margin requirement is greater than 120% of the current updated available collateral.

As noted by ESMA in the Consultation Paper, the use of a one-day MPOR for Gross OSAs typically results in more margin being held by CCPs that can be used for the purposes of a managing its positions when compared to a two-day MPOR for Net OSAs.¹⁹ We would suggest that, given that it has not been implemented for two day MPOR Net OSA models, there is no reason for it to be implemented for Gross OSA models either.

Based on the foregoing, we respectfully recommend that ESMA delete paragraph (3)(c)(iv) and, instead, replace it with a general requirement for all account structures that CCPs calculate and call for margin intraday as appropriate for each client and as is necessary to ensure that any material deficiencies in margin balances are eliminated.

MPOR for OTC derivatives

In draft paragraph (3)(a) of the amended Article 26, we noted that ESMA retained the existing EMIR requirement that a minimum five-day MPOR must be used for OTC derivatives.²⁰ However, we greatly appreciate that ESMA has proposed some flexibility around this requirement in draft

¹⁵ See Joint Response at 4-6.

¹⁶ See Consultation Paper at 8, paragraph 5.

¹⁷ See Joint Response at 7.

¹⁸ See Consultation Paper, 4.3 Annex 3, at 2, draft amended Article 26(3)(c)(iv).

¹⁹ See *id.* at 8, paragraph 5.

²⁰ See Consultation Paper, 4.3 Annex 3, at 2.



paragraph (6) of the amended Article 26 where OTC derivatives have the same risk characteristics as non-OTC derivatives, and a CCP can demonstrate that:

- (1) A shorter MPOR than five days would be more appropriate; and
- (2) Such an MPOR is at least two days, or one day if the relevant conditions are fulfilled.²¹

By providing such flexibility to CCPs and allowing them to margin OTC derivatives contracts based on the risk profiles of the relevant instruments, rather than the category of venue on which they trade, would facilitate more efficient margining of these contracts.

Overall, we look forward to the publication by ESMA of final draft RTS amending Article 26 in advance of the commencement of the clearing obligation for IRS.

If you have questions on any aspect of our response or would like to discuss further, please contact Oliver Robinson (orobinson@aima.org) or Jiri Król (jkrol@aima.org) of AIMA, or Carlotta King (cking@managedfunds.org) or Stuart J. Kaswell (skaswell@managedfunds.org) of MFA.

Yours faithfully,

/s/

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²¹ See *id.* at 3.