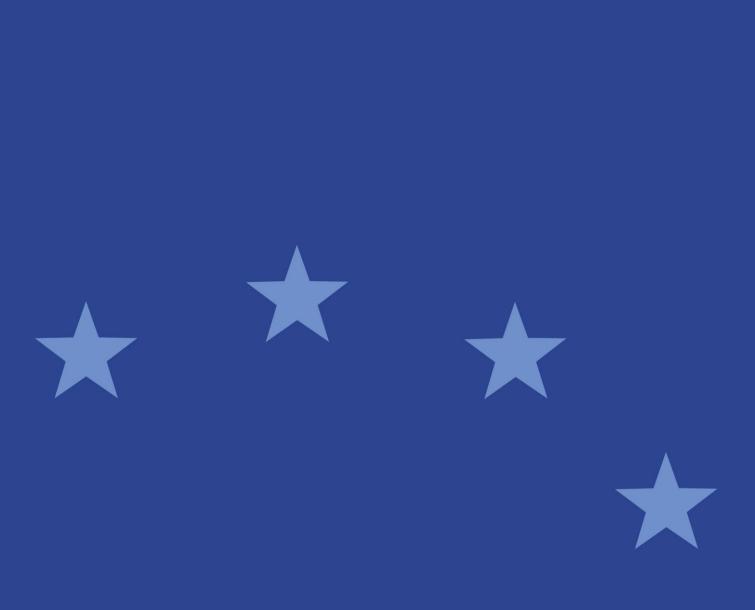# Reply form for the consultation paper on Review of Article 26 of RTS No 153/2013 with respect to MPOR for client

14 December 2015

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 <ESMA_QUESTION_REVIEW_OF_MPOR_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_ 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'.

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](http://www.esma.europa.eu).

Introduction

What is the category you belong to?

<ESMA_COMMENT_REVIEW_OF_MPOR_1>

CCP: ☐

Clearing member: ☐

Client of a clearing member: ☐

Other: ☐, please specify:

<ESMA_COMMENT_REVIEW_OF_MPOR_1>

Please make your introductory comments below, if any:

<ESMA_COMMENT_REVIEW_OF_MPOR_2>

[LCH.Clearnet Group[1] ('LCH.Clearnet') is a leading multi-asset class and multi-national clearing house, serving major international exchanges and platforms as well as a range of OTC markets. It clears a broad range of asset classes including securities, exchange-traded derivatives, commodities, energy, freight, foreign exchange derivatives, interest rate swaps, credit default swaps and euro, sterling and US dollar denominated bonds and repos. LCH.Clearnet works closely with market participants and exchanges to continually identify and develop innovative clearing services for new asset classes. LCH.Clearnet is majority owned by the London Stock Exchange Group, a diversified international exchange group that sits at the heart of the world's financial community.

LCH.Clearnet appreciates the opportunity to provide input to ESMA and fully supports the current regulatory efforts to reach agreement on equivalence between EMIR and the CFTC rules as this will ensure that financial markets operate in a more efficient, secure and competitive manner.

In principle, as stated in our response to ESMA's discussion paper to which we responded in September 2015, LCH.Clearnet supports a liquidation-based minimum holding period by asset class with the ability for CCPs, if required per contract, to increase it if the liquidity analysis proves it insufficient.

We consider that the holding period should be determined by the predicted length of time it actually takes to neutralise the risk of the defaulting clearing member (considering both observable liquidity and the practicalities of porting clients, e.g. operational logistics, of the CCP, the clients, and clearing members; and the bankruptcy laws of the relevant jurisdictions) and not the structure of the account or whether it is house or client.

---

[1] LCH.Clearnet Group Limited consists of three operating entities: LCH.Clearnet Limited, the UK entity, LCH.Clearnet SA, the Continental European entity, and LCH.Clearnet LLC, the US entity. Link to Legal and Regulatory Structure of the Group: http://www.lchclearnet.com/about_us/corporate_governance/le gal_and_regulatory_structure.asp

However, being fully aware of the crucial importance of an equivalence agreement, we welcome the European Commission's and ESMA's pragmatism and flexibility in considering the necessary changes to EMIR in order to provide more options to market participants and facilitate the conclusion of the agreement with the CFTC.

Nonetheless, as a global CCP operating in both jurisdictions and under both regimes (being EMIR authorised and a DCO), we are keen to ensure that such agreement does not lead to systemic instability, liquidity bifurcation or regulatory arbitrage. For these reasons, we strongly advocate that CCPs wishing to offer clearing services to European clients on the basis of a 1-day liquidation period should be subject to additional safeguards in line with those suggested in this consultation.

Moreover, in order to reinforce systemic stability and ensure level playing field, we also believe that additional elements should be taken into account, either in the initial recognition of the jurisdiction as equivalent, or as part of the assessment of each third country CCP's application to ESMA. These are:

- the application of pro-cyclicality buffers;
- the requirements to size the default fund on the basis of the exposure posed by the largest two members (i.e. Cover 2);
- the individual recognition of third country CCPs by ESMA should be done on the basis of the current portfolio of products, when a third country CCP wants to introduce a new product in Europe or make changes to its risk models that affect the services provided in Europe, it should have to receive ESMA's approval:
  - a mechanism mirroring the EU process for new product and services approval (Article 15 of EMIR);
  - a mechanism mirroring the EU process for changes to a CCP's risk models (Article 49 of EMIR); and
- the review of each CCP's recovery plan by ESMA.

Finally, on the grounds that, by proposing a change to EMIR (allowing 1-day liquidation period), the EU Commission recognised that it was a condition to reach an equivalence agreement with the US, we believe that the calendars of the entry into force of the relevant change in EMIR and of the entry of US CCPs in the European market should be aligned.]

<ESMA_COMMENT_REVIEW_OF_MPOR_2>

Questions from the consultation paper

Q1.   Do you have any comment on the draft RTS in Annex 3?

<ESMA_QUESTION_REVIEW_OF_MPOR_1>

[LCH.Clearnet fully agrees with ESMA's proposal that clearing member's affiliates positions should not be commingled with its clients' positions (they should either be included in the clearing member's proprietary account or in a separate dedicated account). This approach would avoid a client's exposure to entities belonging to the same corporate group as its clearing member.

We support ESMA's proposal to apply a new minimum holding period to ISA account structures. Indeed, we believe that, in the case of an ISA, the porting of clients is significantly more likely than in the case of a gross OSA and that an ISA offers a higher level of protection to clients. As a result, the minimum liquidation period requirement for an ISA should not be higher than a gross OSA.

We concur with ESMA on the overall need for more stringent requirements on the calculation and collection of intraday margins for CCPs applying 1-day holding period and on the need for the identity of the clients to be known by the CCP, in order to facilitate porting.

Nevertheless, we would also like to encourage ESMA to request that margin backtesting and stress testing are performed at the client level and that backtesting and sensitivity analyses are extended intraday. This will ensure that initial margins remain accurate during the trading day.

From a systemic stability perspective, we strongly believe that CCPs choosing to use a 1-day holding period should be required to demonstrate their practical ability to run the default management process in 1 day. This process should include declaring the default, informing the client, receiving consent to porting from both the client and the back-up clearing member and finally liquidating any remaining positions that are not transferred. Assuming that the last margin call was paid the day before the default, all of these steps have to be performed on the day the default is declared. All relevant steps from declaration of a default to final liquidation of any non-transferred clients should be included in the assessment of the holding period and deemed operationally feasible with the given time period. This should also apply to default happening intraday.

We believe that regulators should conduct a fair assessment of the practical implementation of the 1-day holding period, including the case where a CCP has a sizeable client portfolio, to ensure that these rules do not result in a *de facto* reduction of margin coverage.

By way of illustration, considering the minimum holding period, the most problematic case would be the situation where a clearing member fails to pay its margin requirements in the overnight run. According to EMIR[2], the time horisons of the holding period starts from the last available margin call, which, depending on the CCP, could be collected between 3pm and 4.30pm. In effect, this means that the EMIR authorised CCPs which want to apply a 1-day

---

[2] Article 26(2) of Commission Delegated Regulation (EU) No 153/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on requirements for central counterparties.

holding period should be able to demonstrate, in practical terms, that they can (i) obtain consent to port from all underlying clients and back-up clearing members and (ii) proceed to liquidate of any non-transferred positions **before 4:30 pm on the day that a default is declared.**

This will have the following consequences
   a) The CCP will, effectively, have a very short porting period, potentially only a few hours (meaning a reduced level of client protection.
   b) For a gross OSA account structure, the CCP must obtain consent to port from each client individually and we do not consider that this can be managed manually when there are a significant number of underlying clients. A very high level of automation seems necessary.
   c) Given that there will be very little time left in the market to liquidate the positions; CCPs choosing to apply a 1-day holding period should have to properly adapt their liquidation method (use of a broker or auction).
   d) In the case of a default happening intraday, there is a risk that, without a strong reporting capability intraday, the CCP might be in a position where it would waste half a day and really start the default management process the next day.

We, therefore, consider that a 1-day holding period requires a very high level of automation while providing a lower level of client protection. As such, there is material risk that this means *de facto* that the 1-day holding period cannot be met in practice and margin coverage will be reduced proportionately. This is the reason why we suggest that, for systemic stability, CCPs choosing to apply a 1-day holding period should not be allowed to do so without having made the appropriate internal arrangements and investments to address the difficulties outlined above.]

< ESMA_QUESTION_REVIEW_OF_MPOR_1>

Q2.   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.

<ESMA_QUESTION_REVIEW_OF_MPOR_2>
[We do not support ESMA's proposal to set a threshold of 120%, as such threshold would still mean that approximately 15% of the initial margin is eroded and client positions are only covered for approximately 85% and for only one day. We consider that the CCP would then be under covered.

If a threshold needs to be part of ESMA's proposal, we believe that it should be significantly lower (e.g. below 10% margin erosion) and that, in addition, a materiality measurement of the uncovered margin should be put in place, for example, either a minimum in nominal term (1 mio €) or a very low percentage of the default fund (e.g.<1%). It is important to note that some CCPs hold very high levels of Initial Margins and that under-coverage of 15% could mean that a very significant amount is missing at the CCP.]

<ESMA_QUESTION_REVIEW_OF_MPOR_2>