



EBA/CP/2014/01

28 February 2014

Consultation Paper

Draft regulatory technical standards
on the margin periods for risk used for the treatment of clearing
members' exposures to clients under Article 304(5) of
Regulation (EU) No 575/2013

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1. Responding to this consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in Section 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by Friday, 9 May 2014. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public 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 the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive summary

In accordance with Article 304(5) of Regulation (EU) No 575/2013 (CRR), EBA has the mandate to draft regulatory technical standards (RTS) specifying the minimum margin periods of risk (MPOR) that institutions acting as clearing members may use as input for the calculation of their capital requirements for exposures to clients.

MPOR are used both for institutions authorised to use the internal model method (IMM) and for those using the non-internal methods (i.e. mark-to-market, standardised method or original exposure method). In the first case, the MPOR will be an input for the internal model, whereas in the other cases, the MPOR determine a multiplier of the exposure value that is less than one. These draft RTS specify different the MPOR for different classes of derivatives to be used in both the internal as well as the standardised approaches, hence covering the full spectrum of derivative types for all counterparty credit risk models.

In September 2013, the EBA circulated a survey and arranged a round table with central counterparties (CCPs) and clearing members to gather the industry stakeholders' preliminary views on this topic. The broad recommendation was to keep the framework as simple as possible, albeit risk sensitive. The estimates provided by the CCPs for the liquidation periods used for initial margin calculations were identified as the best proxies currently available for the MPOR.

Nevertheless, a CCP's estimates of the liquidation periods for initial margin calculations should not be confused with the MPOR for the purpose of building up capital against counterparty credit risk. A CCP's initial margins are supplemented by additional resources (default fund, committed contributions), whereas for a clearing member the capital represents the ultimate financial resource available to absorb losses.

CCP estimates, however, do take into account the liquidity of a class of financial instrument, the concentration of positions in that class, the specific features of the markets used to close out or hedge the positions, and several other factors, suggesting that they are reasonable proxies. Furthermore, CCP estimates of the liquidation periods are subject to supervisory approval and the methodologies are harmonised under European Market Infrastructure Regulation (EMIR).

There are, however, major differences between the risks faced by a CCP and those faced by a clearing member. A CCP will typically have arrangements with members to participate in the hedging or liquidation of a portfolio, contractually generating liquidity, which a clearing member will not. On the other hand, a portfolio inherited by a CCP from a defaulting clearing member is likely to be larger and more complex than a portfolio inherited by a clearing member from a client.

Consequently, on balance, there is a reasonable case for the RTS to set MPOR equal to the liquidation periods of a CCP. Such estimates are subject to a minimum length of five working days, as this requirement stems from Article 304(3) of the CRR. This approach appears to strike a reasonable balance between the risk sensitivity of the MPOR and the simplicity of the approach.

3. Background and rationale

Capital requirements for bank exposures to CCPs were introduced in the Basel Accord via an amendment to the chapter on Counterparty Credit Risk.¹ This amendment requires institutions acting as clearing members (CMs) to hold capital for exposures to both CCPs and bilateral exposures with respect to clients. The European Union implementation of these rules in Articles 301 ff. of the CRR² requires a clearing member to set aside capital against both exposures. These RTS focus on setting aside capital against one of these sets of exposures (the exposures of the CMs to their clients); setting aside capital against exposures to CCPs is beyond the scope of these RTS.

MPOR is defined as the time period from the most recent exchange of collateral covering a netting set of transactions with a potentially defaulting counterparty until the transactions are closed out and the resulting market risk is re-hedged.³ Generally, MPOR under the IMM for counterparty credit risk are estimated by institutions depending on the liquidity of the trades and the collateral in the netting sets, and the floor is that under Article 285(2) of the CRR of 10 days for netting sets that include derivatives and long settlement transactions. A higher floor of 20 days is set by Article 285(3) of the CRR for all netting sets including more than 5 000 trades or containing an OTC derivative that cannot be easily replaced or that involve illiquid collateral. The minimum MPOR is also increased in case of re-margining with a periodicity that is less frequent than daily (Article 285(5) of the CRR) or if the institution has been involved in more than two margin call disputes on a particular netting set over the last two quarters (Article 285(4) of the CRR).

However, institutions acting as clearing members with an approved IMM can determine the capital requirement of the exposure to their clients by applying MPOR shorter than ten days. Article 304(5) of the CRR mandates the EBA to draft a set of RTS specifying the MPOR that institutions may use under the IMM when calculating regulatory capital requirements. For clearing members using the Mark-to-Market Method, Original Exposure Method or the Standardised Method, a reduction in the own funds requirement is obtained by multiplying the exposure value by a scalar less than one.⁴ It should be noted that Article 304(3) of the CRR establishes a minimum length for the MPOR of five days for all different classes of derivatives.

In a similar, although non-identical scenario, CCPs are required to estimate the time horizon for the liquidation of a portfolio of a defaulting clearing member. Under Regulation (EU) No 648/2012 (EMIR)⁵, CCPs are required to estimate the liquidation period based on: the liquidity of a class of financial instruments; the concentration of positions in that class; particularities of the markets used to close-out or hedge the positions; the complexities and level of pricing uncertainties of

¹ [Capital requirements for bank exposures to central counterparties, July 2012, BCBS Paper No 227.](#)

² [Regulation \(EU\) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation \(EU\) No 648/2012.](#)

³ Article 272(9) of the CRR.

⁴ Article 304(1) to (4) of the CRR and paragraph 113 of BCBS Paper No 227.

⁵ [Regulation \(EU\) No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories and Commission Delegated Regulation \(EU\) No 153/2013 of 19 December 2012.](#)

that class; and the risk characteristics including volatility, duration, non-linearity, jump to default, wrong-way risk.

In the course of the preparation of this consultation, the EBA undertook a survey and held a round table discussion with industry stakeholders. The overall reaction can be summarised into two points. Firstly, the effects of this special treatment of the potential use of MPOR lower than the standard ones should be relatively small and should not generate any major market turbulence. Accordingly, the preliminary suggestion of the industry stakeholders was to keep the framework as simple and as consistent as possible with the requirements for CCPs. Secondly, some criticism was voiced, including by the derivative exchanges, that the five-day minimum (set in the CRR in accordance with the Basel Committee rules) would prevent a full alignment with the requirements for CCPs, which was considered more appropriate. This, however, would not be compatible with the requirement in the CRR and remains out of the scope of these RTS.

The authorisation process of a European CCP guarantees a certain level of harmonisation, given that CCP methodologies (including the liquidation periods estimates) need to be validated by the national competent authority (NCA) and are subject to an opinion of the CCP college. Any significant changes to the CCP's models and parameters are subject to independent validation, and to validation by the CCP's NCA and the CCP's college.⁶

On the one hand, when a CCP's estimates of this time horizon are longer than five working days, such estimates should be taken into account in setting the clearing member's own fund requirements vis-à-vis its own clients. As a general consideration, there are a number of structural differences between CCPs and clearing members, which means it is not possible to guarantee that CCP estimates of the liquidation period are always conservative for the purpose of these RTS. For example, a CCP clearing OTC derivatives will typically impose contractual requirements to assist in the management of default, and actively participate in auctions, thereby generating liquidity. An individual clearing member must liquidate (or hedge) with any liquidity available in the market, and thus a clearing member may need more time to liquidate or re-hedge the portfolio of a major client than an efficient CCP. Additionally, a CCP has additional resources available beyond the initial margin calculation (default fund, assessment rights, loss-allocation rules), whereas a clearing member will be reliant on its own capital (after any collateral) to absorb such losses. As such, no false equivalence should be assumed between liquidation periods in CCP margin models and MPOR for capital purposes.

On the other hand, the above differences between the two concepts are mitigated by the practical differences between the likely risk exposure, notably the size and composition of the portfolio. A clearing member will typically inherit a smaller and less complex portfolio from a defaulting client than a CCP would inherit from a defaulting clearing member; where this assumption is accurate, use of the CCP estimate for setting the MPOR would, also for the purpose of these RTS, probably lead to a conservative requirement. Furthermore, to the extent that market conditions are equally applicable to CCPs and clearing members, changes to the CCP liquidation period because of changing market conditions is also relevant for the MPOR for clearing members.

Consequently, notwithstanding the different purpose of the liquidation periods for CCPs and of the MPOR for clearing members under these RTS, CCPs' estimates of the liquidation period for

⁶ In accordance with Articles 41(2) and 49(1) of the EMIR.

margin purposes can be used as a proxy for the MPOR for CMs' capital requirements vis-à-vis their clients. Although that should not create a false equivalence between the two concepts, it has the clear advantage that MPOR change when market conditions change. For example, new products could show an increasing level of liquidity from the moment they are introduced in the market. CCPs' estimates of the liquidation period should capture such trend so that the MPOR used by the institutions as input for counterparty credit risk is reduced proportionally. Since CCPs are required to disclose⁷ to the public information regarding the models used in margin calculations, estimates of the liquidation periods will be available to the clearing members and their supervisors.

The above considerations result in draft RTS that set the MPOR at a level that is equal to whatever is the longer period, the regulatory minimum of five days and the liquidation period disclosed by the CCPs.

⁷ Article 10(b)(vi) of Commission Delegated Regulation 153/2013.

4. Draft regulatory technical standards on the margin periods of risk used for the treatment of clearing members' exposures to clients under Article 304(5) of Regulation (EU) No 575/2013

In between the text of the draft RTS that follows, further explanations on specific aspects of the proposed text are occasionally provided, which either offer examples or provide the rationale behind a provision, or set out specific questions for the consultation process. Where this is the case, this explanatory text appears in a framed text box.

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EUROPEAN COMMISSION

Brussels, **XXX**
[...](2012) **XXX** draft

COMMISSION DELEGATED REGULATION (EU) No .../..

of XXX

[...]

COMMISSION DELEGATED REGULATION (EU) No .../..

of XXX

**supplementing Regulation (EU) No 575/2013 of the European Parliament
and of the Council with regard to regulatory technical standards for the
specification of margin periods of risk for the treatment of clearing
members' exposures to clients**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 575/2013 of 26 June 2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms⁸, and in particular fourth subparagraph of Article 304(5) thereof,

Whereas:

- (1) The framework for the calculation of Margin Periods of Risk ('MPORs') for the computation of capital requirements of clearing members vis-à-vis their counterparties needs to be appropriate both for institutions using the Internal Model Method ('IMM') as well as for those that use the standardised methods. It also needs to reflect changes in the market conditions in order to constitute a prudentially sound approach, while representing minimum burden on these institutions.
- (2) The construction and use of the liquidation periods by the CCPs, while different in nature from the MPORs to be used by clearing members for the purpose of calculating their capital requirements regarding exposures to their counterparties, presents similarities to them given that the estimation of both should take into account close-out periods of contracts and transactions. Given that the use of such periods works for both IMM and non-IMM institutions, it reflects changes in the market conditions, it takes into account of close-out periods of contracts and transactions and it covers all types of products and transactions listed in Article 301(1) of Regulation (EU) No 575/2013, the CCPs' estimates of the liquidation periods should be used as a proxy for the MPORs for the computation of capital requirements of clearing members vis-à-vis their counterparties.
- (3) In order to guarantee that such estimates are subject to supervisory approval, only the liquidation periods estimated by qualifying central counterparties ('QCCPs') as defined in point 88 of Article 4 of Regulation (EU) No 575/2013 should be allowed to be used

⁸ OJ L 176, 27.6.2013, p. 1.

as proxies for the MPORs for the computation of capital requirements of clearing members vis-à-vis their counterparties.

- (4) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.
- (5) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1022/2013.

HAS ADOPTED THIS REGULATION:

Article 1

Margin periods of risk

1. The margin periods of risk of a netting set that institutions may use for the purpose of paragraphs 3 and 4 of Article 304 of Regulation (EU) No 575/2013 shall be determined according to paragraphs 2 and 3.
2. Where the relevant netting set includes transactions cleared with a qualifying central counterparty as defined in point 88 of Article 4 of Regulation (EU) No 575/2013, the margin periods of risk that institutions may use shall be the longer between (a) or (b) below:
 - (a) five business days;
 - (b) the longest liquidation period of the contracts or transactions included in the netting set, as that liquidation period has been disclosed by the qualifying central counterparty with which those contracts or transactions are cleared.
3. Where the relevant netting set includes transactions not cleared with a qualifying central counterparty as defined in point 88 of Article 4 of Regulation (EU) No 575/2013, the margin periods of risk that institutions may use shall be at least ten business days.

Question 1. Respondents are invited to comment on the proposed approach.

Question 2. Clearing members permitted to use the IMM approach are invited to point out the technical issues that could arise under the suggested approach.

Article 2

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission
The President*

*[For the Commission
On behalf of the President*

[Position]

5. Accompanying documents

5.1 Draft cost-benefit analysis / impact assessment

5.1.1 Introduction

1. Article 304(5) of the CRR requires the EBA to develop draft regulatory technical standards (RTS) related to the treatment of clearing members' exposures to clients.
2. Article 10(1) of the EBA regulation (Regulation (EU) No 1022/2013 of the European Parliament and of the Council) provides that before any draft regulatory technical standards developed by the EBA are submitted to the Commission for adoption, the EBA should analyse 'the potential related costs and benefits'. This analysis is to provide an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.
3. The section below includes a cost-benefit analysis and impact assessment of the provisions included in the RTS described in this Consultation Paper.
4. It should be stressed that this methodology does not assume that the liquidation periods of a CCP for setting margins are equivalent to the MPOR for regulatory capital requirements, but it does identify the liquidation periods as the best proxies for this specific application.

5.1.2 Procedural issues and consultation process

5. The EBA organised a round table and ran a written survey to gather the preliminary views of industry stakeholders on this topic. There was a substantial agreement that the alignment between the MPOR and the CCP liquidation periods for initial margin calculations is justified by the fact that CCPs already include in their models the liquidity profile of the transactions, their concentration, the composition of the client portfolio, and the ability to unwind those transactions in the market.

5.1.3 Problem definition

6. Since, under the CRR, institutions acting as clearing members have to set aside capital against counterparty credit risk with respect to the CCPs and to clients, there is the risk that these requirements will eventually disincentivise central clearing. In order to overcome this, the provisions in Article 304 of the CRR introduce a special treatment for the transactions that are centrally cleared by reducing the regulatory capital requirements.

5.1.4 Baseline scenario

7. The baseline scenario can be defined as the set of requirements of the CRR for counterparty credit risk without the reduction in the own funds (capital) requirements under Article 304 of the CRR. Without Article 304, institutions using the IMM would use minimum margin periods defined in the CRR. Institutions using non-IMM methods would not refer to MPOR at all.
8. This section investigates the cost and the benefits of the policy decisions taken when developing these RTS if institutions decide to use shorter MPOR in accordance with Article 304 of the CRR.

5.1.5 Objectives of the regulatory technical standards

9. The objectives of these regulatory technical standards are:
 - a. Capturing risk sensitivity and effectively reflecting it in the margin period as a parameter in the calculation of capital requirements (specific objective).
 - b. Creating a common benchmark for margin periods of risk when calculating own fund requirements for exposure to a client (operational objective).
 - c. Promoting central clearing (specific objective).
 - d. Harmonising the application of the benchmark among the institutions in the EU (general objective).
 - e. Technical standards to set a cost-effective framework such that the regulatory framework will not place an excessive administrative burden on the institutions.

5.1.6 Technical options

10. When developing the technical standards, the following alternative approaches were considered:

Option 1: Static list

The first option considered prescribes a static and predefined list. The list could be determined on the basis of current practices, clearing members' opinions or on a one-off quantitative analysis.

Option 2: Clearing members' internal estimates

Clearing members estimate the MPOR internally and the national supervisory authorities approve the internal methodology of the institutions.

Option 3: CCPs' liquidation periods as proxies

The estimates of the liquidation period that CCPs estimate for initial margin purposes are used as proxies for MPOR.

5.1.7 Assessment of the options

Option 1

11. Option 1 may be considered to be closest to the wording of point (a) of the mandate (Article 304(5) of the CRR).
12. A static list would not be able to capture changes in market conditions such as the volatility in the market value and the level of liquidity of a product over time. A product that is currently highly liquid may in the future have smaller demand, hence lose its liquidity. A static list cannot capture this dynamic behaviour of the product in terms of its liquidity. Similarly, when new products enter the market they may be unknown to investors. In this case, a static list would penalise the products given their low initial liquidity although the volume of trade may increase in the future.
13. Option 1 does not address the problems stated under 5.1.3. It does not provide a sensitive benchmark to capture risks adequately over time and to indicate the optimal level of capital.

Option 2

14. The second option is a viable solution for institutions that use their own internal methodologies (i.e. IMM).
15. This option would be very costly for institutions that rely on other methods because they would have to build their own methodologies and/or change their internal process to estimate the MPOR.
16. Option 2 is not viable because it fails to meet the proportionality criteria.

Option 3

17. Option 3 suggests that the liquidation period that a CCP calculates for the initial margin can be used as a proxy for the MPOR.
18. This option has the following advantages:
 - (a) It is dynamic and captures the volatility in the level of liquidity of the products; therefore, it provides a more sensitive risk analysis to calculate own fund requirements for exposures to clients.
 - (b) The estimates for the liquidation periods are already available for all products and the national supervisory authorities control and approve the methodologies for calculating the liquidation periods (under the EMIR).
 - (c) Therefore, this option will create no additional cost on institutions and on national competent authorities.

- (d) EMIR guarantees a high level of harmonisation. This approach guarantees that a MPOR is available for all products that are centrally cleared.

19. On the other hand, the option has a number of shortcomings:

- (a) The models for calculating the liquidation periods are designed for the margins set by the CCPs and not to assess the additional capital requirements for counterparty risk. The MPOR, on the other hand, is a parameter that clearing members apply when calculating capital requirements for exposures to clients. Therefore, the estimates can only be proxies and not precise indicators for the latter.
- (b) Liquidation periods of non-qualifying CCPs cannot be recognised and the special treatment of Article 304 of the CRR is not applicable.
- (c) It covers all products and does not provide an explicit list of products as referred to in Article 304(5)(a) of the CRR.

20. Having considered the advantages and the disadvantages described above, the EBA developed these draft RTS prescribing the methodology referred to in Option 3.

5.1.8 Costs and benefits

21. Cost to the industry:

- (a) The cost of the approach prescribed in these draft RTS is expected to be lower for institutions using the IMM and institutions using the other approaches. The cost is mainly due to data collection and processing.
- (b) Costs should also be limited for CCPs that are already required to produce the estimates of the liquidation periods which will then be used for MPOR. The additional cost for CCPs is due to the communication of the data and information to the clearing members.

22. Cost to supervisors:

- (a) Clearing members' competent authorities will not need to review any additional methodology for the estimation of MPOR as they are not estimated internally. The source of the additional cost for these authorities is monitoring and inspection activities. This additional cost is expected to be low.
- (b) The methodologies for the liquidation periods are already reviewed during the authorisation process. As a result, the additional monitoring costs to CCPs' competent authorities are expected to be zero.

Question 3. Respondents are invited to provide estimates of the costs and the benefits that the methodology prescribed in these draft RTS is expected to produce with respect to the baseline scenario.

5.2 Overview of questions for consultation

Question 1. Respondents are invited to comment on the proposed approach.

Question 2. Clearing members entitled to use the IMM approach are invited to point out the technical issues that the suggested approach could arise.

Question 3. Respondents are invited to provide estimates of the costs and the benefits that the methodology prescribed in these draft RTS is expected to produce with respect to the baseline scenario.