Variation margin exchange under the EMIR RTS on OTC derivatives

The European Supervisory Authorities (ESAs) have been made aware of operational challenges in meeting the deadline of 1 March 2017 for exchanging variation margin. Based on the material presented to the ESAs, the implementation appears to mainly pose a challenge for smaller counterparties. The 1 March 2017 deadline is part of a globally agreed framework, which aims at ensuring safer derivatives markets by limiting the counterparty risk from derivatives trading partners.

The timeline for implementation has been known in EU since 2015, and it is unfortunate that the financial industry has not managed to prepare for the implementation. Furthermore, a delay of 9 months was already granted by BSBC-IOSCO in 2015 on the basis of similar arguments from the industry. That delay was agreed with the clear expectation that the financial industry would be ready to prepare the implementation within two years.

From a legal perspective, neither the ESAs nor competent authorities (CAs) possess any formal power to disapply directly applicable EU legal text – for instance by issuing non-action letters, which exists in some non-EU jurisdictions. Any further delays of the application of the EU rules would formally need to be implemented through EU legislation, which is not possible at this point in time due to the lengthy process for adopting EU legislation.

As regards difficulties that in particular smaller counterparties are facing, the ESAs expect CAs to generally apply their risk-based supervisory powers in their day-to-day enforcement of applicable legislation. This approach entails that CAs can take into account the size of the exposure to the counterparty plus its default risk, and that participants must document the steps taken toward full compliance and put in place alternative arrangements to ensure that the risk of non-compliance is contained, such as using existing Credit Support Annexes to exchange variation margins. This approach does not entail a general forbearance, but a case-by-case assessment from the CAs on the degree of compliance and progress. In any case, the ESAs and CAs expect that the difficulties will be solved in the coming few months and that transactions concluded on or after 1 March 2017 remain subject to the obligation to exchange variation margin.

Legal basis

The ESAs published on 8 March 2016 the Regulatory Technical Standards (RTS) on risk mitigation techniques for OTC derivatives not cleared by a central counterparty (CCP). These draft RTS were developed on the basis of Article 11(15) of Regulation (EU) No 648/2012 (EMIR), which establishes provisions aimed at increasing the safety and transparency of the over-the-counter (OTC) derivatives markets in the EU.