



## FIA response to EBA consultation on draft Regulatory Technical Standards related to implementation of a new prudential regime for investment firms

Draft RTS to specify the calculation of the amount of the total margin for the calculation of K-CMG (Article 23(3) of the IFR)

(electronic submission to EBA)

London, 4 September 2020

### 1. Introduction

FIA<sup>1</sup> welcomes the opportunity to respond to the EBA consultation paper on the draft RTS related to implementation of a new prudential regime for investment firms published on 4 June 2020. Our response is in relation to the draft RTS specifying the calculation of the amount of the total margin for the calculation of K-CMG (Article 23(3) of the IFR) ('**draft K-CMG RTS**'). The feedback provided in this response is from the perspective of the clearing members, which are indirectly impacted by the K-CMG requirement, and not from the perspective of the investment firm clearing clients, although points raised in our response may be aligned with the comments made by the investment firms.

FIA clearing members are generally supportive of the solutions set out in the draft K-CMG RTS, in particular in relation to the limited additional regulatory burden on clearing members. The draft K-CMG RTS seems to have shifted the onus on investment firms to demonstrate 'suitability' of the clearing members' margin models.

### 2. Definition of total margin required

FIA clearing members recommend a drafting change to the proposed calculation of the amount of the total margin required in Article 2(1) of the draft K-CMG RTS for reasons set out below. We believe that it can be simplified and clarified as follows:

*"The amount of the total margin referred to in Article 23(2) of Regulation (EU) 2019/2033 shall be the ~~required~~ amount of collateral ~~in the collateral account comprising the initial margin, variation margins and other financial collateral, as required by the clearing member's margin model~~ ~~from the investment firm~~, to cover for current and potential future exposures resulting from change in market price of net positions, for the trading desks subject to CMG."*

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<sup>1</sup> FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 countries as well as technology vendors, law firms and other professional service providers.

FIA's mission is to:

- support open, transparent and competitive markets,
- protect and enhance the integrity of the financial system, and
- promote high standards of professional conduct.

As the principal members of derivatives clearinghouses worldwide, FIA's clearing firm members play a critical role in the reduction of systemic risk in global financial markets.



As the investment firm can have several collateral accounts with the clearing member and because the requirement is linked to 'required amount' of collateral, the reference to 'collateral account' is not required, because it does not seem to matter in which collateral account the required amount of collateral is recorded.

Explicit references to initial margin, variation margin and other financial collateral may also be superfluous and possibly limiting, because clearing members may not use the same terminology and may also accept non-financial collateral as margin, such as gold or other commodities.

Given that K-NPR may be used for calculating the capital requirement for one or more trading desks and, at the same time, K-CMG may be used as the methodology for other trading desks, it is important to define 'total margin required' such that it allows for simultaneous use of K-CMG and K-NPR by different trading desks within the same investment firm. The proposed drafting attempts to define 'total margin required' such that it is limited to those trading desks that use K-CMG methodology.

### **3. Use of multiple clearing members**

If the investment firm uses more than one clearing member, Article 3 of the draft K-CMG RTS requires that firm to calculate K-CMG by first determining the third highest amount of total margins required on a daily basis by each clearing member separately over the period of preceding three months, possibly on two different trading days, before adding them and multiplying the sum by 1.3.

According to investment firm clients, the calculations that they have made show that the EBA proposed approach would result in a higher and overly conservative capital requirement for them compared to the scenario where they use a single clearing member or a scenario where they use multiple clearing members, however the investment firm client is required to add total margins required by each clearing member on a daily basis on the same trading day, and then determine the third highest amount over the last three months and multiply it by 1.3. This methodology would also appear to better capture the risk that K-CMG is meant to address and capitalize, as investment firm clients manage risk on the basis of positions that they have on each day, rather than across different days.<sup>2</sup>

If the proposal remains unchanged, then the investment firm clients will be incentivized to only utilize clearing services of a single clearing member to optimize their regulatory capital treatment, which in turn means that in the event of default, it may be more difficult for them to port positions and assets to a back-up clearing member, as well as increases concentration and leads to less competition among clearing members.

FIA clearing members suggest that the EBA change the proposed approach such that the investment firm client, who uses multiple clearing members, needs to first add amounts of total margin required for each clearing member on the same (i.e. single) trading day for the preceding three months, and then take the third highest amount of the total margins required across clearing members, before multiplying it by 1.3.

For reasons set out above, we propose the following drafting changes to Article 3 of draft K-CMG RTS:

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<sup>2</sup> We note that the FCA shares this view and proposes a 'third highest combined daily total of margin given on a single day' in the recent DP20/2 on a new UK prudential regime for MiFID investment firms (see section 6.69 of the FCA DP20/2).

*“For the purposes of calculating the K-CMG as referred to in Article 23(2) of Regulation (EU) 2019/2033, where an investment firm makes use of the services of more than one clearing member, the investment firm shall calculate the K-CMG by first adding up, across all clearing members used, the margins for each day, determining the third highest amount of total margins required on a daily basis by each clearing member separately over the preceding three months, then adding those amounts and multiplying the outcome by 1.3.”*

#### **4. Publication of erroneous margin figures**

In the rare and unlikely event that a clearing member publishes an erroneous margin figure (e.g. due to a clerical error), it is the FIA clearing members’ understanding that the clearing member is permitted to retract/recall the erroneous margin figure, and replace it with the correct number as soon as the error has been identified. We recommend that the EBA expressly clarifies this point in the final K-CMG RTS.

#### **5. Materiality of margin model changes**

FIA clearing members note the materiality threshold of margin model changes in draft K-CMG RTS Article 4(2)(b)(ii). In terms of practical implementation of this requirement, the clearing members believe that it is up to each clearing member to monitor whether and when changes to its own margin model trigger a change of 10% or more of required margin, and that the requirement does not introduce an additional recording or publication requirement of all margin model changes (i.e. also those that fall below the 10% threshold). Where margin required is based upon CCP requirements, notification for such changes should be sought from the CCP rather than the clearing member.

#### **6. Territorial scope**

FIA clearing members note the definition of ‘clearing member’ in IFR Article 4(1)(3) and its limitation to the clearing members established in the European Union (‘EU’). As a result, investment firm clients, who are subject to K-factors and who clear through a non-EU clearing member (often on a non-EU CCP) cannot benefit from IFR Article 23 (K-CMG) as K-CMG is limited to client clearing arrangements that include an EU clearing member. This may have an undesired and ‘cooling’ effect on competition, as the requirement discriminates against non-EU clearing members, which may lead to further concentration of client clearing activity in a few clearing members or in a few CCPs, without the underlying economic rationale. We would argue that K-CMG should be available to EU investment firms irrespective of the location of the clearing member that they use.

We are conscious that this is a Level 1 issue, however we wanted to bring it to the EBA’s attention in the context of this consultation response.

#### **7. Personal scope**

FIA clearing members note that IFR Article 23 appears to be limited only to clearing clients where they are direct clients of an EU clearing member. However, investment firms can also be clients of direct clients of clearing members (i.e. *indirect clients*) or even direct members of the CCP (i.e. *clearing members*). While we recognise that this is a Level 1 issue, we would like to raise it with the EBA with a view to exploring whether IFR Article 23 can be interpreted such that K-CMG can also be available to investment firms who are indirect clients (i.e. clients of (EU) direct clients of clearing members) and to those who are direct members of the CCP, as the nature of the underlying market risk and exposure that K factors for Risk-to-Market cover are comparable to those that direct clients face when clearing through a clearing member.



Thank you for consideration of these comments. We would be happy to discuss them in more detail with you as required. Please contact the undersigned at +44 (0)20 7519 1831 or [msiraj@fia.org](mailto:msiraj@fia.org) in case of any questions or to schedule a follow-up call.

Respectfully submitted,