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Via Electronic Mail

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Re: EMIR Margin RTS – Equity Options Derogation and Money Market Funds Permitted as Eligible Collateral

Dear Sirs and Madams:

Managed Funds Association (“MFA”)¹ appreciates that the European Supervisory Authorities (“ESAs”) will imminently issue proposed revisions to the European Commission Delegated Regulation (EU) 2016/2251 (“EMIR Margin RTS”)² in the context of the EMIR Refit framework.³ MFA supports the European Commission (“Commission”) in its objectives to achieve “cost reduction and simplification”⁴ as well as “reducing regulatory and administrative burdens”⁵ through EMIR Refit. Consistent with the Commission’s objectives and in anticipation

¹ Managed Funds Association 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 many other regions where MFA members are market participants.

² Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32016R2251&from=EN>.

³ Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32019R0834&from=EN>.

⁴ EMIR Margin RTS, recital 2.

⁵ *Id.*

of the ESA's issuance of the EMIR margin proposal, MFA would like to raise to issues with the scope of the EMIR Margin RTS that we believe it is appropriate for the ESAs to consider. In particular, MFA respectfully requests that the ESAs:

- (1) Extend the time-limited derogation for single-stock and index equity options (together, "**Equity Options**") to prevent market fragmentation and regulatory arbitrage; and
- (2) Expand the scope of money market funds ("**MMFs**") permitted for use as initial margin ("**IM**") beyond UCITS to include issuing entities that have similar MMF regulatory oversight within their applicable regime.

MFA believes that there is broad support from both clearing members and clients on these requests,⁶ and that they would be beneficial to all market participants and the continued convergence of global derivatives regulations.

I. Extension of the Equity Options Derogation

MFA asks the ESAs to extend the time-limited derogation for Equity Options to prevent market fragmentation and regulatory arbitrage.

As you know, Article 38(1) of the EMIR Margin RTS provide a time-limited derogation for all non-centrally cleared OTC derivatives that are Equity Options to extend the phase-in period before Equity Options become subject to the EMIR Margin RTS. However, the current derogation will expire on January 4, 2020 (*i.e.*, three years after entry into force of the EMIR Margin RTS). MFA's understanding is that this derogation was granted initially to avoid market fragmentation and to ensure a level playing field for market participants that trade on a global basis because, in some jurisdictions (*e.g.*, the U.S.), Equity Options were not subject to equivalent margin requirements.

As when the Commission provided the current derogation, it remains the case that in the U.S. Equity Options are not subject to margin requirements. Specifically, in the U.S., the Dodd-Frank Act⁷ excludes Equity Options from the "swap" definition. As a result, single-stock equity options are not subject to the margin requirements under the rules finalized by the U.S. prudential regulators⁸ or the U.S. Commodity Futures Trading Commission ("**CFTC**").⁹ In addition, while the Dodd-Frank Act classifies index equity options as "security-based swaps"

⁶ MFA notes our support for the letters submitted to you by the International Swaps and Dealers Association, Inc. reiterating these same concerns and requests.

⁷ See Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, available at: <https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf> ("**Dodd-Frank Act**").

⁸ See U.S. prudential regulators final rule on "Margin Requirements for Covered Swap Entities", 83 Fed. Reg. 50805 (Oct. 10, 2018), available at: <https://www.govinfo.gov/content/pkg/FR-2018-10-10/pdf/2018-22021.pdf> ("**PR Margin Rules**").

⁹ See CFTC final rule on "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants", 83 Fed. Reg. 60341 (Nov. 26, 2018), available at: <https://www.govinfo.gov/content/pkg/FR-2018-11-26/pdf/2018-25602.pdf> ("**CFTC Margin Rules**").

subject to regulation by the U.S. Securities and Exchange Commission (“SEC”), the SEC has yet to implement rules applying margin requirements to relevant index equity options.¹⁰

Therefore, in MFA’s view, the reason that the Commission granted the derogation for Equity Options continues to exist. As a result, it is important and appropriate for the Commission and the ESAs to extend the derogation from Equity Options.

II. Expansion of MMFs Permitted as Eligible Collateral

MFA requests that the ESAs extend the scope of MMFs that market participants are permitted to post as IM to include funds beyond UCITS. Specifically, we ask that, in the EMIR margin proposal, the ESAs provide that non-EU MMFs and other issuing entities that have similar MMF regulatory oversight within their applicable regime may be used as eligible collateral.

A. Summary of U.S. and EU Regulations

Both in the U.S. and European Union (“EU”), the regulatory requirements for the margining of non-cleared derivatives allow for the use of MMFs as collateral. However, each regulatory regime imposes restrictions that, in practice, mean that there are no MMFs that are eligible under both the EMIR Margin RTS and either the PR Margin Rules or the CFTC Margin Rules. As a result when an entity in scope of the PR Margin Rules or the CFTC Margin Rules, faces an entity in scope under the EU regulatory regime, neither counterparty may post cash to be reinvested into an MMF nor directly post an MMF as collateral. Where substituted compliance is available, the conditions on use of substituted compliance mean that, depending on the location of the parties, either U.S. or EU MMFs can be posted, but not both. This restriction significantly decreases the options for viable eligible collateral considering settlement and transfer timing limitations and global fragmentation.

B. Industry Use of Cash and MMFs as Collateral

Cash is widely used as collateral in the derivatives market. According to the latest ISDA Margin Survey,¹¹ 75.3% of derivatives collateral posted is cash. Cash settlement processing is efficient, fungible, and a high quality and liquid asset. Cash is often then swept into a MMF to reduce custodian risk, among other reasons. Posting cash is a necessity for entities both directly and indirectly subject to the IM requirements because:

- (1) Firms may not have ready access to eligible non-cash collateral;
- (2) Firms may not have the operational infrastructure and/or the capacity to efficiently transform cash to eligible collateral;

¹⁰ See SEC final rule on “Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers”, 84 Fed. Reg. 43872 (Aug. 22, 2019), available at: <https://www.govinfo.gov/content/pkg/FR-2019-08-22/pdf/2019-13609.pdf>.

¹¹ Available at: <https://www.isda.org/a/nleME/ISDA-Margin-Survey-Year-End-2018.pdf>.

- (3) Transformation outside the custodian can be costly for firms with less scale;
- (4) Holding securities specifically in anticipation of collateral calls creates a drag on performance and decreases investment performance for end investors; and
- (5) There are situations where transformation is not possible or practical prior to posting (e.g., due to reinvestment/custodian cut-off times).

For both voluntary and mandatory IM, clients have steadily increased the use of third-party IM segregation arrangements and to meet regulatory required margin settlements deadlines. As a consequence, there has been increased use of MMFs as a secure and efficient reinvestment option with cash margin.

C. Broadening Eligible MMFs Beyond UCITS

In order for pledgers to meet their own and their counterparty's regulatory obligations, eligible collateral may need to meet multiple regulatory regimes' requirements. For example, when an EU entity that is a financial counterparty ("FC") or non-financial counterparty above the clearing threshold ("NFC+") trades with a U.S. swap dealer ("SD") that would be an FC if it were established in the EU, the U.S. and EU rules will both apply (the availability of substituted compliance, discussed further below). Based on the current EMIR Margin RTS, only MMFs that are UCITS may be posted as eligible collateral – no other type of MMF is permitted. However, under the PR Margin Rules and the CFTC Margin Rules, MMFs that are UCITS do not qualify as eligible collateral due to their ability to use repurchase transactions. As a result, in the example above, the EU entity could not post cash for reinvestment into a MMF, unless substituted compliance is available.

To accommodate a global market, MMFs other than UCITS must be available as eligible collateral. Therefore, MFA requests that the ESAs expand the requirements regarding which MMFs are eligible collateral to include issuing entities that have similar MMF regulatory oversight within their applicable regime.

D. Proposed Amendment Language

MFA considers that the most simple and effective way to expand the scope of eligible collateral as needed is to amend Article 4(1) of the EMIR Margin RTS to include:

- (1) Shares or units in MMFs authorized in accordance with the EU Money Market Funds Regulation;¹² and
- (2) Non-EU collective investment undertakings that are subject to supervision equivalent to that set out in the EU Money Market Funds Regulation.

¹² Regulation (EU) 2017/1131, available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017R1131&from=EN>.

MFA's proposed amendment to Article 4(1) of the EMIR Margin RTS would read as follows:

Article 4

Eligible collateral

1. A counterparty shall only collect collateral from the following asset classes:

[...]

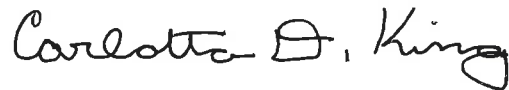
(s) (new) shares or units in money market funds authorised in accordance with Regulation (EU) n°2017/1131 and non-EU collective investment undertakings that are subject to equivalent supervision to that set out in the Regulation (EU) n°2017/1131.

MFA appreciates your consideration of the EMIR Margin RTS matters raised in this letter. We welcome the opportunity to discuss our views with you in greater detail. Please do not hesitate to contact the undersigned at (202) 730-2600 with any questions you or your respective staffs might have regarding this letter.

Respectfully submitted,



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