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ESAs Opinion on bilateral margining of equity options

Opinion on the application of the provisions relating to non-centrally cleared OTC derivatives which are single-stock equity options or index options under Article 38(1) of Commission Delegated Regulation (EU) 2016/2251 of 4 October 2016 supplementing Regulation (EU) No 648/2012 (EMIR)

Description of the issue and legal basis

1. Commission Delegated Regulation (EU) 2016/2251¹ contains a range of implementation timelines, including a phase-in period for the requirements set out in Article 11 of Regulation 648/2012 (EMIR) as specified in Articles 9 to 18, points (c), (d) and (f) of Article 19(1), Article 19(3) and Article 23 of Regulation 2016/2251 (“bilateral margin requirements”) for non-centrally cleared OTC derivatives which are single-stock equity options or index options (“equity options”). In particular, such requirements have been first deferred for three years in accordance with Article 38 (1) of Commission delegated Regulation 2016/2251 and then further deferred until 4 January 2024 as per Article 1(5) of Commission Delegated Regulation (EU) 2021/236².
2. The objective of the phasing-in of the bilateral margin requirements for equity options, as explained in Recital 43 of Commission Delegated Regulation (EU) 2016/2251, has been to avoid market fragmentation and ensure a level playing field with other jurisdictions taking into account the nature of these transactions and the relevant international developments. As mentioned in Recital (8) of Commission Delegated Regulation (EU) 2021/236, such objectives remained unchanged, and are still to this day valid, with some jurisdictions outside the Union having not yet implemented such requirements for equity options, and others having introduced deferrals in the meantime.
3. The ESAs have already advised in June 2023, in the context of the ongoing EMIR review³, that a long-term solution for equity options should be provided having regard to international developments as well. The ESAs have, to that end, discussed in their advice the different parameters and conflicting objectives⁴.
4. In the present situation and pending any long-term solution that could be introduced via the EMIR review, there is a transitional period applying regarding the bilateral margining requirements for equity options. More specifically, this transitional period as set out in Article 38 (1) of Commission Delegated Regulation (EU) 2016/2251 means that equity options currently benefit from a temporary exemption from the bilateral margining requirements. This transitional period is now due to expire on 4 January 2024.

¹ Commission Delegated Regulation (EU) 2016/2251 of 4 October 2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty (OJ L 340, 15.12.2016, p. 9–46).

² Commission Delegated Regulation (EU) 2021/236 of 21 December 2020 amending technical standards laid down in Delegated Regulation (EU) 2016/2251 as regards to the timing of when certain risk management procedures will start to apply for the purpose of the exchange of collateral (OJ L 56, 17.2.2021, p. 1–5).

³[https://www.europarl.europa.eu/RegData/docs_autres_institutions/commission_europeenne/com/2022/0697/COM_CO M\(2022\)0697_EN.pdf](https://www.europarl.europa.eu/RegData/docs_autres_institutions/commission_europeenne/com/2022/0697/COM_CO M(2022)0697_EN.pdf)

⁴https://www.esma.europa.eu/sites/default/files/2023-06/ESA_2023_11_-_ESAs_Letter_on_Bilateral_margining_and_equity_options.pdf

5. In view of a potential long-term solution resulting from the on-going legislative procedure and taking also into account the fact that the situation justifying the temporary exemption (i.e. the need to avoid market fragmentation and to ensure a level playing field for counterparties established in the Union) has not changed since the last time the temporary exemption was renewed, the expiry of the transitional period would create a temporary situation when there would be a need for clarification on the operational and legal arrangements needed. The ESAs are thus of the view that this issue should be addressed in order to ensure continuity with the current treatment.
6. Continuity with the current treatment would avoid the risk of creating undue instability in the operations of market participants with respect to the applicable regulatory framework, i.e. it would avoid the possible situation where market participants would suddenly need to implement the necessary operational and legal arrangements as the exemption expires, and then to stop them if the exemption is later reintroduced by the co-legislators in the finalisation of the EMIR review.
7. To that end and without prejudice to the outcome of the ongoing EMIR review, the ESAs have developed on 18 December 2023 draft regulatory technical standards amending the Commission Delegated Regulation (EU) 2016/2251 in order to further phase-in the treatment of the equity options until 4 January 2026.
8. The ESAs hereby explicitly acknowledge the practical difficulty for the proposed amendment to Commission Delegated Regulation (EU) 2016/2251 to have been processed before the expiry of the transitional provision set out in Article 38 (1) of that Regulation on 4 January 2024. They also acknowledge that the introduction of a long-term solution is pending. Against this background, the ESAs consider that the instability in the operations of market participants regarding equity options would raise, albeit temporarily, significant exceptional issues pertaining to market confidence as market participants will have to set in place immediate arrangements for margining these products until a final decision is made on the matter. In addition, an interruption of the current treatment would risk market fragmentation which in turn would affect the orderly functioning of financial markets in the short term.
9. There is, therefore, an urgent need for the ESAs to adopt this Opinion in order both to provide the Commission with their view on any action they consider appropriate and to further ensure the consistent, efficient and effective supervisory and enforcement practices, and the common, uniform and consistent application of the relevant provision dealing with the exemption from bilateral margining for equity options by competent authorities.

10. The ESA's competence to deliver this Opinion in the form of a no-action letter is based on Article 9c (4) of Regulation (EU) No 1093/2010⁵, Article 9a (4) of Regulation (EU) No 1095/2010⁶ and Article 9a(4) of Regulation 1094/2010⁷ which provide that the ESAs may issue no-action letters, if the absence of a delegated act that would complement or specify the legislative act in question would raise legitimate doubts concerning the proper application of such act.

Specific proposals

11. The Commission should prioritise the decision relating to the adoption of the amending draft technical standards [include title of the standards that the ESA are going to adopt] to ensure continuity with the current treatment thereby avoiding market fragmentation by avoiding instability in the regulatory framework applicable to equity options.
12. From 4 January 2024 until the entry into force or rejection of the proposed amendment to the Commission Delegated Regulation 2016/2251 or the adoption of any long-term solution in the context of the EMIR revision, whichever occurs first, the competent authorities should not prioritise any supervisory or enforcement action in relation to the requirements set out in Article 11 of Regulation 648/2012 as specified in Articles 9 to 18, points (c), (d) and (f) of Article 19(1), Article 19(3) and Article 23 of Regulation 2016/2251 in respect equity options.

⁵ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

⁶ Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84–119)

⁷ Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC