

Segregation mechanisms for accounts under EMIR

The study has been conducted based on a review and interpretation of the most recent documents received by us from the clearing houses LCH and ICE and from certain banks as part of their clearing member service offering.

We aim to share our understanding of the various clearing mechanisms, as this is a topical and evolving subject. EMIR requires that central counterparties (CCPs) and clearing members implement account segregation mechanisms in order to secure assets provided as collateral. Four current segregation models are listed below.

A - Net Omnibus segregation

In the Omnibus model, client accounts are aggregated at clearing member level (no segregation at CCP level). The positions and collateral of clients in “Net Omnibus” accounts are recorded on a net basis and margin calls are calculated by the CCP on this net basis.

This mechanism offers the least protection and is also the least expensive. This is a solution that may be used for portfolios handling investments that involve increased risk and large volumes of derivatives.

Advantages:

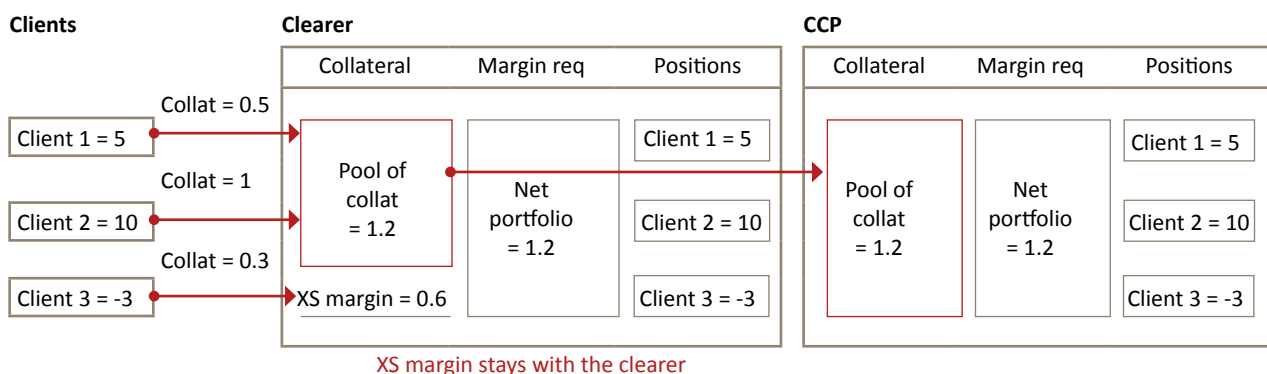
- Reduced cost

Disadvantages:

- Risk associated with the netting applied by the clearer resulting in a partial transfer to the clearing house of the collateral paid
- Risk in respect of the excess cash paid which stays with the clearer
- Fellow customer risk: the clearing house holds collateral for a pool of clients without the option to allocate this collateral to the members of the pool
- Transformation of securities collateral through risk-generating equivalents in difficult markets
- Portability to another clearing member not possible in the event of default by the initial clearing member

Net Omnibus mode of operation

Simplifying assump. 10% of linear collateral



B - Gross Omnibus segregation

As a reminder, in the Omnibus model, client accounts are aggregated at clearing member level (no segregation at CCP level). The positions of clients in “Gross Omnibus” accounts are however recorded on a separate (gross) basis and margin calls are calculated by the CCP on each position. Positions and collateral are still commingled however.

This mechanism is promoted by clearing members; while it is more secure than the Net Omnibus model, it does not eliminate risk.

Omnibus Gross Value Omni could prove to be the logical choice for many management companies, as it seems to offer the best compromise among security, ease of implementation and cost. The sponsored principal offerings currently under development may be an alternative.

Advantages:

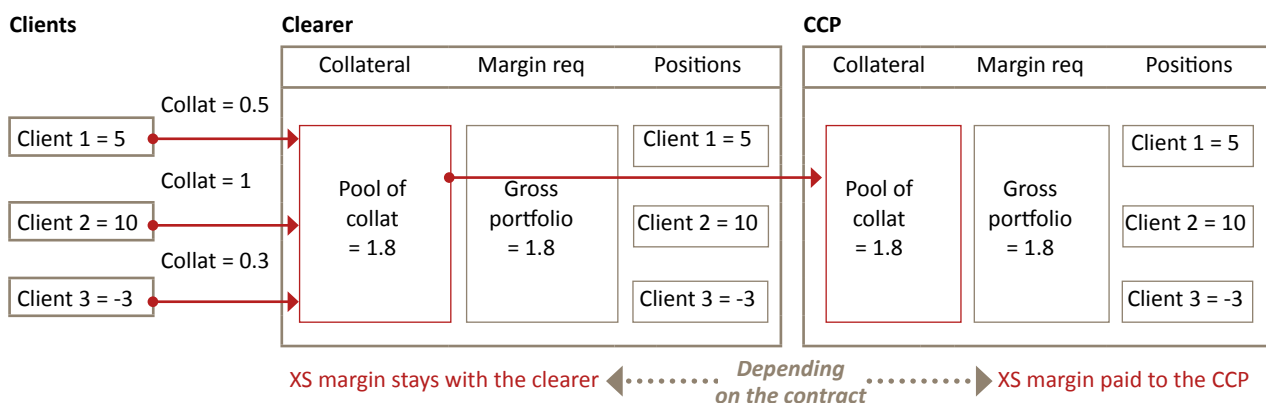
- Model promoted by clearers
- Greater security than Net Omnibus
- The OSA Gross Value Omni account allows pooling to be limited to a group of known and accepted clients (such as funds belonging to a single management company)

Disadvantages:

- Risk for excess cash if it stays with the clearer
- Fellow customer risk: the clearing house holds collateral for a pool of clients without the option to allocate this collateral to the members of the pool
- Transformation of securities collateral through risk-generating equivalents in difficult markets
- Portability to another clearing member is possible in theory but complicated and untested, calling into question its operational feasibility

Gross Omnibus mode of operation

Simplifying assumpt. 10% of linear collateral



C - Individually Segregated Accounts (ISAs)

This model separates clients’ accounts and clearing members’ accounts, thus enabling the CCP to calculate the level of collateral and margin calls at the most granular level (the fund).

ISAs are the most secure mechanism but are more expensive. Management companies may opt for this model to provide maximum security for all portfolios or for certain sensitive portfolios.

Advantages:

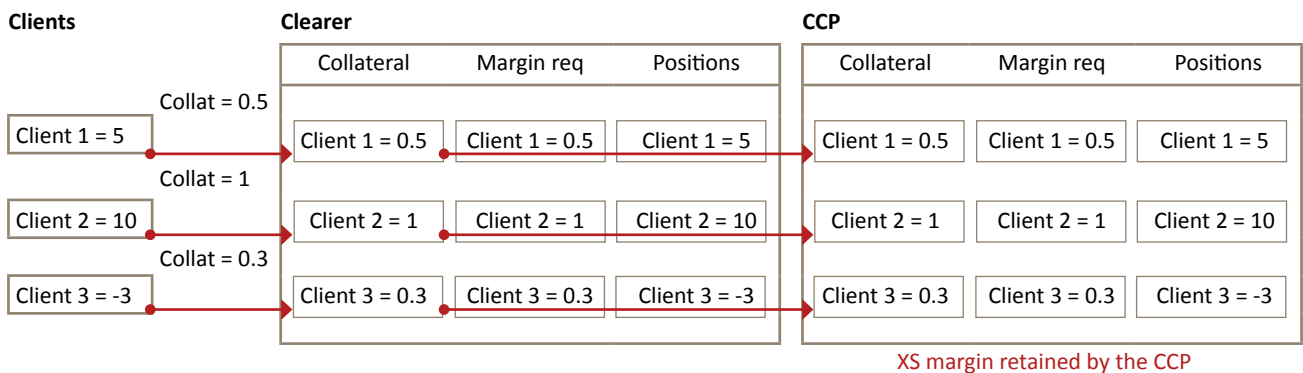
Assurance that securities provided as collateral will be returned, which is more secure compared with the return of equivalent securities in distressed markets when valuations are difficult. It also allows to post collateral for funds that do not accept the transformation.

Disadvantages:

- Offers protection in principle, but this has not been tested in a real situation
- Clearing members are reluctant to implement this type of segregation
- Pre-funding is sometimes required
- Greater cost

ISA mode of operation

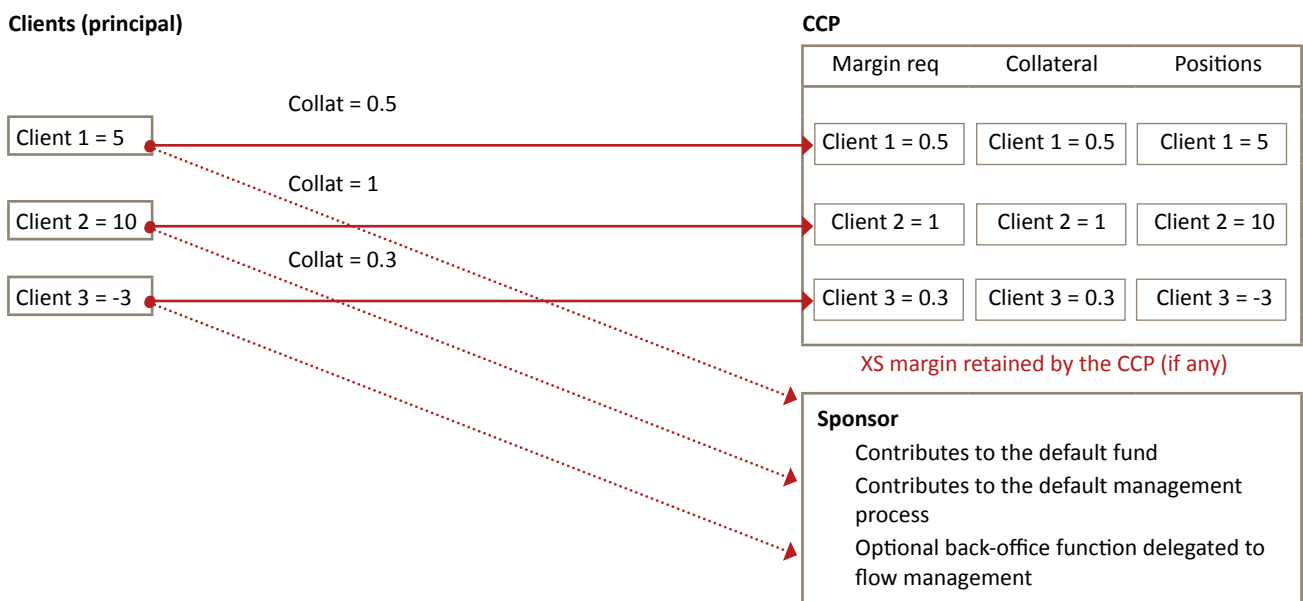
Simplifying assumpt. 10% of linear collateral



D - Sponsored principal method

The method of operating as a principal with CCPs, by using a sponsor and no clearing member, is an emerging, alternative mechanism currently only offered by certain clearing houses. While it is an interesting concept, the operational procedures are not yet known.

Sponsored principal diagram



E – Appendices

1) Models proposed by ICE Clear Europe and LCH.Clearnet for IRS and CDS

Group of accounts	ICE Clear Europe		LCH.Clearnet	
	Account type	Cost (*)	Account type	Cost (*)
Net Omnibus			OSA net AssetOmni	1.200
Gross Omnibus	Segregated Customer Omnibus Account (T)	Waived	OSA Gross ValueSeg	3.500
	Segregated Customer Omnibus Account (S)	Waived	OSA Gross ValueOmni (other known clients)	
ISA	Individually Segregated Operationally Co-minglet Account (ISOC)	5.000	ISA AssetSeg	3.500
	Sponsored Principal	25.000		

* Fees in EUR per account charged by the clearing house, to which the clearing member's fees are to be added

2) Risk factors addressed in negotiations with clearing members

Trading limits	Amount and notice for changes
Haircuts	Same haircuts as CCPs or difference
Collateral	Collateral restrictions
Additional risk exposure	Extra IM, excess cash buffer

This document has been produced by the “EMIR segregation mechanisms” working group, chaired by Denis Michel (Natixis Asset Management), in collaboration with Pascal Gallagher (Candriam). This group is attached to AFG’s Risk Management Technical Committee.

AFG would like to thank all members of the working group for their contributions.

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