Regulation of CCPs and the Enforcement of Investor Rights

Dr. Pablo Iglesias-Rodríguez
VU University Amsterdam

Conference on Intermediated Securities and Investor Rights
London School of Economics and Political Science
24.03.2014
The CCP Clearing Process

Buyer

Trader A

Clearing Member

CCP

Trader B

Seller

Buy

Sell
The Contractual Nature of Investor Rights in CCP Clearing

At EU level CCP Clearing traditionally out of the scope of hard law

Very heterogeneous CCP Clearing regimes
The Chain of Contracts in CCP Clearing

Agency Model

Client → Principal
Principal → Clearing Member
Clearing Member → Principal
Principal → Agent
Agent → Client

Principal Model

Client → Principal
Principal → Clearing Member
Clearing Member → Principal
Principal → CCP

Client at the end of the chain in both models
Exposed to risk of default by either the CM or the CCP
Regulation of CCP Clearing through contracts and the position of clients

Rights of clients set in vague and unclear contracts

Contracts devised for the protection of CCPs and/or CMs

Failures in chain of intermediation may have impact on:
1. The conclusion of CCP Clearing
2. The assets (cash, securities..) provided by clients as margin
Post-crisis Regulatory Overhaul

- EU level: from soft-law to hard law

- European Market Infrastructure Regulation (EMIR)

- Potential for greater protection of clients and investors: segregation and portability

- Limitations: what CCP’s regulation does not (or cannot) do.
What Can Regulation Do (1)?: EMIR and Segregation

Omnibus Segregation

- CCP
- Account CM
- Account Clients CM

Individual Segregation

- CCP
- Account CM
- Accounts Clients CM
  - Account Client A
  - Account Client B
  - Account Client C
The Regulation of CCPs: limits (1)

1. CCP liquidates and transfers value of assets to client: EMIR grants discretion to CCPs
2. CCP liquidates and transfers value of assets to CM: problem of insolvency laws

DEFAULT OF CM

No claim against CCP

Client

Claim against CM

Clearing Member

Insolvency

CCP
The Regulation of CCPs: limits (2)

DEFAULT OF CCP

Client shielded: only in theory

Scope for contractual waivers of liability

Example: the ISDA CM Disclosure Document:

“...your claims against us are limited recourse so that you will only receive amounts from us in relation to Client Transactions if we receive equivalent amounts from the CCP in relation to relevant CCP Transactions;”
The problem of the applicable law: Winding Up, Insolvency…

Conflict between provisions different countries

The Regulation of CCPs: limits (3)

DEFAULT OF CM OR CCP IN A CROSS-BORDER CHAIN
What Can Regulation Do (2)?: EMIR and Portability

THREATS ENFORCEMENT

CLIENT RIGHTS:

A) Omnibus segregation: no individual portability

B) Individual segregation:

1. Insolvency: positions and assets seen as part of the defaulting CM’s estate

2. Portability requires ex-ante agreement with CMs
Conclusions (1)

- Financial crisis had led to regulatory intervention in area of CCP Clearing
- Enhancement of some rights of clients in CCP process
Conclusions (2)

- The approach of EMIR and its weaknesses:
  - Objectives
    - Competition and avoidance of systemic risk
    - Give preeminence to position of CCPs and CMs
  - Core aspects of client protection often dismissed
    - Risk for the effective and efficient enforcement of client rights
  - Technique
    - Delegation to CCPs and CMs, not to ESMA
Conclusions (3)

- The intrinsic limitations of the regulation of CCPs:
  
  Other areas of law have substantial influence on the ability of clients to enforce their rights
Thank you!