

13.08.2015

## PUBLIC CONSULTATION BY THE EUROPEAN COMMISSION ON EMIR

### FBF'S ANSWERS TO THE COMMISSION

#### PART I: Questions on elements of EMIR to be reviewed according to Article 85(1)(a)-(e)

##### Question 1.1 : CCP Liquidity

- (i) Is there a need for measures to facilitate the access of CCPs to central bank liquidity facilities?

Yes.

- (ii) If your answer to (i) is yes, what are the measures that should be considered and why?

CCP access to central bank liquidity would be a very welcome step, not only in times of stress but also in normal market conditions. This access should not be restricted to the CCPs with a banking license. CCPs currently rely on liquidity arrangements with commercial banks, which exposes them to the ability of the commercial banks to provide liquidity, including in particular on intraday basis. Considering that in most cases the commercial banks providing CCP with liquidity are at the same time members of the CCP, there is potential for negative feedbacks in case any of the institutions is unable to meet its liquidity obligations. Given the systemic role that the CCPs have acquired following from the global OTC derivatives reform, it is essential for them to be as robust as possible. Access to central bank liquidity would be an important means to that end, and it would eliminate the need for CCPs to have highly secured arrangements for overnight cash deposits over at least 95% of the cash.

Moreover, central bank liquidity access would be of particular importance in case a CCP was facing non-default related liquidity problems. A central bank liquidity line would further protect CCP and its users from contagion, as it would only be reasonable not to spread the risk of an ailing CCP risk onto commercial liquidity providers and/or CCP members. In this sense, commercial bank liquidity arrangements for CCPs, whether in stress or not, could represent a wrong way risk for the CCP and its users.

This wrong way risk for liquidity should be avoided particularly when the commercial institution providing liquidity to a CCP is at the same time a Securities Settlement system ("SSS") where the financial instruments posted to the CCP are held on deposit. Collateral safekeeping arrangements should neither impede nor prejudice the choice of the most robust and safest choice for liquidity provision arrangements from the point of view of the systemic

risk. Moreover, exposure limits for the highly secured arrangements for financial instruments and cash should apply not only to commercial institutions acting as clearing members (as in Art. 44(1) EMIR), but to any institution with which a CCP enters into liquidity or cash deposit arrangements.

### **Question 1.3 : CCP Colleges**

(a) What are your views on the functioning of supervisory colleges for CCPs?

The re-authorization process for the purpose of EMIR was very intransparent for the users and doesn't allow them to prepare and plan sufficiently in advance. More transparency and more consistency in the authorization process would allow clearing members to develop a more consistent offer across all CCPs.

(b) What issues have you identified with respect to the college system during the authorization process for EU CCPs, if any? How could these be addressed?

By way of concrete examples:

- We would welcome more transparency towards users concerning the authorization process of CCPs, as well as concerning the procedures and processes around ensuring ongoing compliance (changes in CCP risk policies [margining, default fund ("DF")] and operational changes) and extending the authorization (new products and services). We would welcome that the relevant information is disclosed (at least) to the users at the moment when the CCP makes application for the approval of the measures that it envisages to implement.
- Users should also have more visibility of the (re-)authorization process: at what stage is the application and within which time horizon decisions should be expected.
- The above considerations are particularly important for those CCP services and products that do not fall under the scope of EMIR, and for which the National Competent Authorities have large discretions as to timelines and the process to follow. Requirements for CCP colleges in Art. 17 EMIR should be extended to authorization applications for non-EMIR products and services, and more transparency should apply as well.

### **Question 1.4 : Proccyclicity**

(a)

(i) Are the requirements under Article 41 EMIR and Article 28 Regulation (EU) n°153/2013 adequate to limit procyclical effects on CCPs' financial resources?

No.

(ii) If your answer to (i) is no, how could they be improved?

We find that that the current recommendations in Art 28 of the EMIR implementing regulation are too rigid and do not correspond to the specificities of the various products subject to clearing. The regulation should establish principles upon which measures against the pro-cyclicity should be based and not prescribe quantitative standards. The level of margin buffers, the degree of the risk weight adjustment, and the historical period used for the construction of margining methodologies should be specific to the product in question. This is due to the fact that different products can have different inherent product life cycles. For example, certain equity-based products traditionally spike in the dividend season, or energy contracts typically spike around January, but those spikes are not signs of volatility, instead they are natural for the product to occur in the specific time of the year.

The regulation should allow the CCP to manage efficiently the volatility that is fairly predictable and inherent in the product life cycle (micro level pro-cyclicality), as well as to mitigate pro-cyclicality effects at the macro level, taking more complex factors into account. Therefore it is important that CCPs have robust stress-tests and methodologies in place, and use historical and hypothetical scenarios that are most appropriate for the product in question.

(b)

(i) Is there a need to define additional capacity for authorities to intervene in this area?

We do not see the need for more supervisory intervention in this context. The role of the supervisors is to assess CCPs' internal risk management procedures and to approve the methodologies used. CCPs should remain responsible for the construction and application of their risk management process, on the basis of the existing minimum requirements established by EMIR.

#### **Question 1.5 : CCP margins and collateral**

(a)

(i) Have CCPs' policies on collateral and margin developed in a balanced and effective way?

Yes for the collateral policies, no for the margin policies.

The CCPs policies on collateral are developed in a balanced way. They allow clearing members to ensure appropriate risk management, both facing the CCP and facing the client, by applying own standards for the collateral accepted from clients which they either post directly to the CCP or which they transform before posting it to the CCP.

We also find that highest quality collateral is necessary in order to enhance both the possibility of a successful liquidation as well as successful porting. The higher the quality of the collateral, the higher its resistance to market volatility, particularly in stress markets. Collateral that is highly resistant to volatility better averts the risks of under-collateralisation or of liquidation at a higher haircut. We therefore believe that there is no need to adjust the provisions on eligible collateral. In addition, CCPs should consider market risk and liquidity risk when performing asset valuation and apply conservative concentration limits in order to avoid wrong-way co-relations.

(ii) If your answer to (i) is no, for what reasons? How could they be improved?

Concerning margin methodologies, more transparency from the CCPs towards users is needed to enable the latter to correctly assess the risks towards the CCP and towards the clearing clients. At present, in the derivatives sphere, clearing members are not always able to reconstruct the actual levels of exposures towards their clients on the basis of the information and the margin calls received from the CCPs. This is particularly the case for positions held in net omnibus accounts at CCP level, but remains a valid issue for gross omnibus accounts as well.

Similarly for the contributions to the CCP default fund, more transparency towards users would be commendable, in particular concerning the nature of the exposures represented by the two largest clearing members, as well as concentration limits for assets accepted by the CCP for the Default Fund contributions. This would allow the clearing members to better assess and anticipate their own risk level related to the CCP risk not covered by the margins (effectively the no-covered market risk) and to plan better for the contributions to the DF.

(b)

- (i) Is the spectrum of eligible collateral appropriate to strike the right balance between the liquidity needs of the CCP and its participants?

We consider the balance to be sufficient. In line with the answer to point (a) above, we recall the duty of the clearing members to ensure that only high quality collateral is used, and to have in place adequate commercial policies towards their clients that ensure that the requirements on collateral quality at the CCP level are respected .

Also, from the point of view of the risks being pooled at the CCP level, those clearing members who ensure high quality of the collateral should not be exposed to undue risks created by other clearing members accepting from clients and posting to the CCP collateral of lower quality. Safeguarding the right balance in this respect (collateral quality, concentration limits) is largely the responsibility of the CCP.

## **PART II: GENERAL QUESTIONS**

### **Question 2.1: Definitions and scope**

- (i) Are there any provisions or definitions contained within Articles 1 and 2 of EMIR that have created unintended consequences in terms of the scope of contracts or entities that are covered by the requirements?

Yes.

- (ii) If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?

EMIR references to MiFID for the product scope. The differences in the interpretation of the term “*derivative contracts*”, as based on the definitions of financial instruments provided for in Annex I Section C, have led to implementation discrepancies across the EU Member States and beyond. This has been at the root of EMIR compliance problems for firms facing counterparties in jurisdictions applying divergent interpretation of the EMIR scope. We are waiting for the clarification regarding in particular the FX spot definition.

We are aware of the remedy to this situation that could be provided by the MiFID II implementing measures (currently under development), which should hopefully clarify the definitions for derivatives based on currencies and commodities for the firms authorized in the EU. However, the problem will persist in the future for those firms who will continue dealing with counterparties in third country jurisdictions.

For instance, in the US, the FX transaction for which the settlement date is pegged to the settlement date of the underlying securities were clearly exempted from all DFA obligations and do not fall into the definition of a “*swap*” produced by the CFTC [cf “*Federal Register /Part II/ CFTC 17 CFR 1/SEC 17 CFR Parts 230.240 and 241 Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping; Final Rule/ page 51 – 48257*]. We point to the fact that the CFTC approach is shared and applied also by the FCA and the CSSF who allow transactions to have a settlement horizon up to T+7 to be considered as a spot transaction.

More clarity is also needed for the treatment of the branches of EU institutions situated outside the EU jurisdiction, both when entering into transactions with third non-EU parties as well as in the context of intragroup operations, both in and out of the EU. This is particularly the case for affiliated entities in jurisdictions without an equivalence decision.

A more workable regime for **requesting** an equivalence decision for third country jurisdictions would be welcome.

### **Question 2.2 : Clearing obligations**

(a)

(i) With respect to the access to clearing for counterparties that intend to clear directly or indirectly as clients; are there any unforeseen difficulties that have arisen with respect to establishing client clearing relationships in accordance with EMIR?

Yes.

(ii) If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?

### **Indirect clearing mechanism: the portability should not be imposed on clearing members**

Territorial issues: the development of a viable commercial offer for indirect clearing is impeded by legal, operational, and commercial uncertainties. By the experience with the extraterritorial effects of EMIR, legal certainty and the minimum level of predictability of the risks related to indirect clearing is limited to the EU territory, i.e. the situation when the indirect client, the direct client, and the clearing member are **all** EU-entities.

From the legal perspective, the guidance on the territorial scope of application of the indirect clearing arrangements (ESMA Q&As) should be incorporated into the Level 1 text in order to become legally binding. Provisions relating to indirect clearing should reflect the fact that the structure of indirect clearing implies **two** intermediaries (the clearing member and the direct client), and that **both** intermediaries should be under the scope of EMIR (i.e. be EU entities) so that the protections of Art. 39 of EMIR be available to the indirect client. Equally, it should be made clear that protections of Art. 39 cannot be guaranteed when a non-EU CCP is used. Unless the condition that **both** intermediaries are based in the EU is fulfilled, duties of the intermediaries should be discharged through appropriate disclosures to the indirect client about the reasons and consequences of the protections under Art. 39 being unavailable to them.

FBF further considers that indirect clearing must not be mandatory, for the following reasons:

- there is a risk of insolvency because of the lack of recognition of indirect clearing arrangements by national insolvency regimes (i.e. EMIR's indirect clearing provisions may be challenged by the insolvency legislations applicable to the direct and indirect clients located within the EU; besides, EU law does not supersede third country jurisdictions and, consequently, if the direct client is located outside EU, the client's local legislation will be applicable);
- An EMIR-compliant indirect clearing offering is not available also for risk and prudential reasons: (i) some clients are less attractive due to the credit risk they raise to the clearing member; consequently, clearing members must not be required to compromise their risk management standards with the sole view of facilitating clearing; (ii) the leverage ratio limits the capacity of clearing members to provide clearing services to clients;

- whatever the potential resolution of such legal and prudential issues, FBF considers that it is crucial for clearing members to retain the discretion whether or not to offer indirect clearing. making the indirect clearing mandatory may result in a large number of clearing members closing their clearing activities. FBF considers that EMIR regulation should be adjusted in order to minimize the risk of contraction of the number of clearing services providers.
- Finally, in the acknowledgement that the indirect client clearing offer is inexistent, FBF supports the alternative of bilateral margining (i.e. counterparties posting initial and variation margins on a bilateral basis).

Finally, FBF and AFTI consider that Article 39 of EMIR should be modified so as to clarify that the principle of portability, pursuant to EMIR, is and can only be applicable to derivative contracts and not to other financial instruments.

(b)

- (i) Are there any other significant ongoing impediments or unintended consequences with respect to preparing to meet clearing obligations generally in accordance with Article 4 of EMIR?

Yes.

- (ii) If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?

### **Frontloading requirement: the risks linked to this obligation justify its removal**

The frontloading requirement creates significant pricing and market risk management challenges:

First, market participants will be unable to accurately price trades that will be cleared at a future date:

- Clearing houses typically require that the currency of the derivative determines the currency of the mark-to-market collateral posted on a daily basis (variation margin) but OTC derivatives are often subject to various collateral agreements. This implies that derivatives denominated in one currency are collateralised with different currencies, and thus valued using different discount rates;
- Many OTC derivatives traded in the frontloading window will be subject to a re-pricing adjustment at the point when they are frontloaded into a CCP. If this future revaluation is not reflected at trade inception, one of the parties will suffer a loss when the trade is cleared. However, pricing a trade, which will be valued differently at a certain point in the future increases pricing complexity significantly;
- There are different pricing approaches adopted, each with a varying degree of complexity, hence valuation disputes may be frequent;

Secondly, market participants may face market risks (liquidity and stability) which could be very complicated to address properly:

- Counterparties may not have a clearing arrangement in place at the time when the clearing obligation takes effect. As clearing members are likely to be unwilling to pre-commit to clear the contract, dealers will assign into the pricing a probability that the trade will clear (by widening the bid-offer);

- The risk that some counterparties may have been unable to put clearing arrangements in place by the time the clearing obligation takes effect may entail numerous OTC contracts to be terminated or assigned whereas terminating or assigning the transaction may not be possible if the clients disagree (in which case banks will keep in their books uncleared derivative contracts – while these contracts are eligible for clearing - at the risk of being sanctioned by supervisors). The legal and operational process surrounding this mass termination exercise would be considerable.

In light of the above the frontloading requirement should be removed, Failing which, FBF advocates at least a limitation of the frontloading requirement to the transactions entered into with Category 1 counterparties. this limitation would substantially reduce uncertainties and risks since, as of today, the huge majority of transactions entered into with these counterparties are already cleared on a voluntary basis.

Concerning the client categorization: (which is partially linked to the frontloading issue), this issue is creating an additional layer of complexity for banks. It proved to be highly challenging and resource consuming to get accurate information (if any) from their counterparties on their status and category (categories 2 to 4 counterparties in particular). This is even more difficult for non-EU counterparties. It remains very uncertain whether banks would have the capacity, despite many efforts, to classify their counterparties in the appropriate category and start central clearing at the right time with a specific counterparty.

#### **Suspension of the clearing obligation:**

As of today, there are no provisions for a temporary suspension or definitive termination of the clearing obligation, either in situations of market urgency, or when the market segment for a particular product has shifted substantially since the entry into force of the clearing obligation.

The 1st case is e.g when a “monopolist” CCP for a specific product is in crisis (or resolution) and submitting further contracts to clearing in that CCP would represent a hazard for the counterparties. The 2nd case is illustrated by a situation in which the liquidity of a given product has significantly dwindled over time, to the extent that: i) it does not anymore correspond to the liquidity levels that led to the introduction of the clearing obligation for that product, and/or ii) as a consequence of the former, and/or other factors, pooling the risks associated with clearing of that particular product with other products cleared in a CCP would inflict undue risk on the CCP and on to its users. 3rd case is product unsuitability, where a market stress may ensue without liquidity shortage but manifests itself through extreme volatility: e.g. inflation swaps are often dealt by end-users in the same direction (all hedge against inflation upside). In case of default of a big end-user, the neutralization of the clearer’s risk might lead to a sudden need for very directional hedges, which may cause uncontrollable effects on the market. Nota bene, the regime for suspension/withdrawal of the clearing obligation should not be too rigid: suspending the clearing obligation should not entail an obligation to de-clear.

#### **Question 2.3 : Trade reporting**

- (i) Are there any significant ongoing impediments or unintended consequences with respect to meeting trade reporting obligations in accordance with Article 9 of EMIR?

Yes.

- (ii) If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?

### **Trade reporting: requirement to backload historical dead trades should be removed**

Pursuant to EMIR, the reporting obligation applies to derivative contracts which (a) were entered into before 16 August 2012 and remain outstanding on that date; or (b) are entered into on or after 16 August 2012. In the draft technical standards under the EMIR, ESMA has granted a 3 year transitional period to perform the backloading.

As a result, the backloading of historical “*dead*” trades which expired before February 2014 (date of entry into force of the reporting obligation) but are still subject to EMIR reporting remains a task which many firms have not completed yet.

Since backloading is performed using the same data fields / format as for the reporting of new trades, Trade Repositories apply similar validation rules for both backloaded and for new reports. This situation requires significant efforts: (i) “*dead*” trades must have a trade reference that respects UTI format; (ii) counterparties must be identified through valid counterparty identifiers (example LEI) while they might not have performed any new derivatives trading since February 2014, or not be an active client any more of the firm that is EMIR eligible.

Furthermore, the reporting and storage of the backloadable data are costly (and remains costly also for Trade Repositories as the recordkeeping obligation lasts for 10 years) while the use of this data and the added value it brings to the monitoring of systemic risk is questionable and disproportionate compared to the cost.

Consequently, FBF considers that the backloading of historical dead trades should be removed.

### **Trade reporting: requirement to perform matching/pairing on expired trades must be removed**

While we understand the requirement for EMIR trade reporting to pair and match key data fields related to live trades, we question the benefits of the pairing and matching of expired trades. Indeed, this requirement creates a lot of noise and takes away the focus from the live trades. These detrimental effects may be significant as the number of expired trades will increase – and adding these trades to the matching reports will soon become a technical burden (reports are already very heavy even with only the live transactions on them).

There are fundamental reasons explaining why some trades do not match or cannot match: inter Trade Repositories trades are very hard to match. Consequently, the list of unmatched dead trades is unmanageable.

Furthermore, there are technological issues which limit resolution of breaks on “expired” trades: reporting of trades past maturity date might not be reprocessed by the Trade Repositories.

Lastly, transactions that are expired do not present systemic risk. Therefore, firms / Trade Repositories should be entitled to focus instead on the pairing and matching of live transactions.

FBF would thus welcome clarification that expired trades should not be included in the Trade Repositories matching and pairing.

## **“Level 2” validation rules: the agenda for stakeholders to comply with ESMA new data validation rules is very challenging**

As specified by ESMA in its Q&A on EMIR (as updated on April 27, 2015), while the first level of validation rules (entered into force since December 1, 2014), refer to “*determining which fields are mandatory in all circumstances*”, the second level validation rules refer to the “*verification that the values reported in the fields comply in terms of content and format with the rules set out in the technical standards*”, with a view to improving both the quality and the reliability of the reporting data. Considering their scope and complexity, ESMA has granted the Trade Repositories a phase-in period of 6 months (i.e. until end of October 2015) to implement these “level 2” validation rules.

We appreciate that the industry had been consulted on this topic (through the ESMA’s Consultative Working Group). However, we regret that the industry has not been further consulted during the process of defining new data quality requirements, for the two following reasons :

- Being at an upstream part of the process would have given the banking sector extra-room for supporting this important momentum ;
- In spite of the 6 month-phase-in period granted by ESMA, the contemplated agenda is very challenging for the banks. Indeed, implementing a level 2 validation rules covering all the reports and ensuring an improvement of the data quality requires significant IT and human resources.

## **ESMA’s consultation on the review of the RTS / ITS on reporting: the proposed changes and modifications are confusing**

ESMA proposed modifications on RTS and ITS are problematic as (i) they present inconsistencies with the reporting currently carried out to the Trade Repositories and (ii) they would not enable the banks to report certain types of transactions properly (such as these on commodity derivatives), notably due to the inconsistencies above mentioned.

Other professional associations such as ISDA and FIA have also clearly underlined these issues.

While the banking sector had been asked to express its views on this issue with limited visibility on the regulatory reporting framework planned by ESMA (limited visibility increased at that time by the consultation on the contemplated “level 2” validation rules) , FBF would have preferred (i) a more consistent agenda for the industry’s consultation and (ii) ESMA to be more responsive to the industry’s remarks and comments.

## **Conflicting obligations regarding banking secrecy law**

EMIR provides for that the reporting of derivative contracts to a Trade Repository registered shall not be analysed as a breach of any restriction on disclosure of information, notably banking secrecy law.

As already highlighted, this exemption from the banking secrecy rules only covers the EU legislation and regulation. Consequently, this exemption does not apply to transactions reported to non-EU Trade Repositories deemed non-equivalent. This is critical for French banks if local (non-EU) banking secrecy law applies and the client refuses to sign a consent to the disclosure of its identity. Indeed, in this case, French banks will face conflicting obligations: to comply either with their reporting obligation or with the banking secrecy rules. In both cases, the banks would face a regulatory risk (and in France a criminal risk in case of breach of banking secrecy rules).

Currently, this conflict of laws is handled on a case-by-case basis by the individual Member States. We encourage European Commission to provide for a pan-European solution, and for more detailed guidance in cross-border context.

#### **Question 2.4 : Risk mitigation techniques**

- (i) Are there any significant ongoing impediments or unintended consequences with respect to meeting risk mitigation obligations in accordance with Article 11 (1) and (2) of EMIR?

Yes.

- (ii) If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?

#### **Portfolio compression trades: these trades should be exempted from clearing requirements**

EMIR imposes the clearing of new trades resulting from systemically risk-reducing processes such as multilateral portfolio compression cycles.

FBF considers that this requirement should be removed for the following reasons:

- Compression cycles are designed to reduce risk and allow firms to manage exposure more efficiently. Since risks are already reduced with the compression mechanism, clearing compression trades is unnecessary to meet EMIR's risk mitigation objective;
- This requirement may even have a negative impact on market liquidity. Compression cycles allow firms to manage their exposures more efficiently and as such facilitate banks' ability to provide greater liquidity to the market. Conversely, submitting banks to a clearing requirement for such compression trades may reduce their ability to perform this function.

#### **On a general level, industry is facing an array of issues relating to risk mitigation that stem from the inconsistencies as to the scope of EMIR in different EU jurisdictions and beyond:**

- Portfolio reconciliation: it is impossible to perform portfolio reconciliation correctly when there is discrepancy as to what forms part of the portfolio in different jurisdictions. We urge to provide a solution to this problem across the EU jurisdictions in the least by providing for a clear and unambiguous definition of instruments under the EMIR scope
- Confirmation is also inconsistent across jurisdictions: in the case of certain swaps, some counterparties only confirm the forward leg and not the spot leg, other confirm both. We would appreciate more regulatory guidance in this respect
- Dispute resolution: there are discrepancies between the industry practice and supervisory practice for dispute resolution which, on a cross-border basis, cause firms to face an impossible choice between the breach of commercial obligations or breach of supervisory requirements. In particular, the provisions of the ISDA dispute resolution protocol to which the industry widely adheres are not endorsed by certain national competent authorities. This concerns the crucial aspects of triggers and process. In result, firms may be caught between what the home regulator requires from them and what the counterparty in another jurisdiction is expecting. We urge ESMA to ensure more consistency among the regulators in the supervision of dispute resolution while taking into account the established industry best practice.

### **Question 2.5 : Exchange of collateral**

- (i) Are there any significant ongoing impediments or unintended consequences anticipated with respect to meeting obligations to exchange collateral in accordance with Article 11 (3) under EMIR?

Yes.

- (ii) If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?

On a practical level, we note that for margin posted in cash, cross-currency haircuts prove to be operationally difficult to implement.

Concerning segregation and re-use of the assets posted as initial margins ("IM"), we point to the recently closed second ESAs' consultation on non-cleared margin requirements, and several issues that arise in the context of posting and safekeeping of the posted IM.

The high level requirement of the BCBS-IOSCO Principles ("BCBS 261") that margin must be immediately available to collecting party in the event of the counterparty's default and the collected margin must be subject to arrangements that protect the posting party from the collecting party's bankruptcy is neutral in terms of the collateral arrangement chosen, i.e. pledge versus title transfer, and enable the collateral to be posted in securities as well as in cash.

The EU regime should follow the BCBS Principles and not impede the choice between the collateral arrangement or the choice of the form of the collateral (cash or securities). The duty to segregate the collateral and the prohibition of its reuse by the collecting party is contrary to the legal construction of the title transfer collateral arrangement, and it is wholly unpalatable for the collateral posted in cash. Cash being fungible, it is a credit claim of the account holder against the relevant account bank and the return of the cash is inherently linked to the solvency of the counterparty holding it. Similarly to the cash collateral issue, securities collateral posted with the title of transfer is by their nature a credit claim and it is simply impossible to eliminate the credit risk without eroding the title transfer. Consequently, duties to segregate and restrictions on re-use are contrary to and hollow the title transfer collateral concept. Against this background, the reference to the custodian risk should be removed from the RTS.

### **Question 2.6 : Cross-border activity in the OTC derivative markets**

- (a)
- (i) With respect to activities involving counterparties established in third country jurisdictions, are there any provisions or definitions within EMIR that pose challenges for EU entities when transacting on a cross-border basis?

Yes.

- (ii) If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?

**Third countries equivalence: a level playing field between jurisdictions is needed to protect the interests of European banks and their counterparties**

FBF considers that equivalence decisions, particularly for clearing and margin requirements, is crucial (i) to achieve a regulatory level playing field across jurisdictions and (ii) to avoid any

competitive disadvantage for the European banks and / or their counterparties (which would be the case, for instance, if margins should be posted and collected multiple times).

This is why FBF wishes to make the following suggestions:

- Where EU counterparties trade with non-EU counterparties established in, or subject to the rules of, an EMIR Article 13(2) equivalent jurisdiction, the parties should be entitled to mutually agree on the set of equivalent rules to apply for a specific trade. This would facilitate transactions by and between EU and non-EU counterparties that are required to comply with or that strongly wish to apply another set of rules (notably, the US ones);
- EMIR Article 13(3) should allow the adoption of separate equivalence acts regarding the obligations provided for by Articles 4, 9, 10 and 11 rather than a single all-encompassing equivalence act;
- Given EMIR Article 13 does not provide any guidance with regard to the process or timeline for the delivery of equivalence decisions, FBF considers that (i) third countries should not be required to apply for an European Commission equivalence determination (which may not prevent the European Commission from opening discussions with third country regulators); and that (ii) further guidance on the expected timeline for a EU equivalence would be needed to for clarification purposes.

FBF wishes to remind that EU firms are very active in most major markets (notably the US; Switzerland, Asia etc.) and, consequently, that an absence of equivalence decisions may have significant negative impacts on the provision of financial services in those markets to both local entities and EU clients seeking to access such markets.

Notably, an absence of equivalence decisions may incentivise market participants to focus on their trading activities in their local markets. This situation, if any, would result in liquidity fragmentation and a loss of market efficiencies, which is not the intended policy outcome.

By way of practical examples of impediments in cross-border activities:

Extraterritoriality in trade reporting: the process of recognising third country TRs for the purpose of EMIR has been inefficient, which is resulting in double reporting for market participants: report made to a TR in a non-EU jurisdiction for a transaction with a counterparty located there is not recognised in the EU, consequently, a second complete report must be made to an EU TR for the same trade. We urge ESMA to speed up the TR recognition process.

Extraterritoriality effects in portfolio reconciliation: for a trade executed outside the EU between a fund domiciled in Taiwan and an EU counterparty, an EU fund administrator for the Taiwan fund is forced to perform portfolio reconciliation despite the fund itself is not under such obligation domestically.

Extraterritoriality in trade reporting: for a trade between an EU counterparty and a US counterparty, both have to report under the respective domestic legal regimes (EMIR and D-FA, respectively), however without the TR recognition the status of the reports on both sides remains “unmatched”.

(b)

- (i) Are there any other provisions within EMIR that create a disadvantage for EU counterparties over non-EU entities?

Yes.

- (ii) If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?

See our answer to point (a) here above.

### **Question 2.8 : Requirements for CCPs**

(a)

- (i) Are there any significant ongoing impediments or unintended consequences with respect to CCPs' ability to meet requirements in accordance with Titles IV and V of EMIR?

No, but please see our answer to point (b) hereunder.

(b)

- (i) Are the requirements of Titles IV and V sufficiently robust to ensure appropriate levels of risk management and client asset protection with respect to EU CCPs and their participants?

No.

- (iii) If your answer to (i) is no, for what reasons? How could they be improved?

Liquidity risk controls: robust arrangements to ensure the continuity of CCP critical services are essential to prevent a non-default related CCP crisis. CCP liquidity arrangements should go beyond the case of a member default as currently foreseen in Art 44 EMIR. In respect of Art 32 of the EMIR impl. regulation we suggest:

- Art 32(3)(b): CCPs should assess their liquidity needs in case of default- and **non-default-related stress**. CCP liquidity needs assessment should be akin to the assessment of the costs of maintaining the critical services for a **sufficient period of time**, not only on a daily or intraday basis.

- Art 32(3)(c): the assessment of liquidity needs should go **beyond the daily** CCP liquidity needs;

Transparency and disclosures: more transparency concerning margining, stress testing, DF modelling and concentration limits would improve the ability of clearing members to assess and manage risks towards the CCP and towards the clients. In particular, margin methodology should be sufficiently predictable and understandable to clearing members. CCPs should also provide users with more information on the investment policy, so as to allow the users to assess the associated risks. We recall that the representatives of CCP users in CCP risk committees are there in their personal capacity and are usually bound by non-disclosure obligations vis-à-vis their own establishment (they are expected to defend/represent the interests of the CCP and not to represent the interests of their establishments)

Stress-testing: a more prescriptive approach is needed, so as to ensure that CCPs consider sufficiently conservative time horizons, relevant historical & hypothetical data, and that the stress-tests are appropriate in the context of the given product and/or segment. This said, stress testing requirements for CCPs should be rules-based, so as to allow the CCPs to construct stress-test models most appropriate to their services and to the risks borne by those services.

CCP investment policy and highly secured arrangements : exposure limits should apply for the re-investment of cash and financial instruments in accordance with Art 39(8), Art 47(1) of EMIR and Art 44(3) of the implementing regulation. Such limits should not apply to deposits made with central banks. Since Art 47(1) EMIR requires that any re-investment bear only a minimal market risk, CCPs should have the possibility to open an investment account with a central bank for the financial instruments it receives. This would additionally reinforce the robustness of the CCP liquidity and allow the CCP to renounce to commercial type repo operations in order to access liquidity.

### **Highly secure arrangements [Art 47(3) 468/2012 and 44 153/2013]**

AFTI and FBF consider that the European Commission should precise that CCPs should have the option to either deposit the assets received as collateral and DF contributions within a direct account at an SSS, or use a highly secured arrangement, The framework would be enhanced on three aspects:

- Client assets protection:

There is no difference in the level of asset protection whether the CCP is a direct member of the SSS or uses a segregated account in the books of the SSS, operated by a custodian. In both cases, the assets are clearly segregated and protected from any third party claims, and benefit from the protections under the Settlement Finality Directive, notably the irrevocability of transfers.

- Macro-prudential safeguards and minimization of undue costs/complexity

The requirement for a CCP to use exclusively a direct account at an SSS actually results in additional risks and in higher complexity to the process of transfer and management of collateral:

- posting collateral to the CCP still requires the involvement of a transfer agent and a transfer account at the level of the specific SSS that the CCP has selected. This hinders the instantaneity of transfer and the efficiency of substitution, and results in higher transaction risks and operational costs for derivatives users.

- similarly to problems facing users who want to post collateral, CCPs cannot rely on global custodians: no single (EU or other) SSS can ensure universal access by a CCP to collateral deposited worldwide. As a practical consequence, CCPs have to use global custodians to manage collateral transfers between multiple CCP direct accounts in various locations. This challenges the objective that CCPs should rely only on own direct custody account. At the same time, the lack of harmonisation in the settlement practices between various SSS makes the use of global custodians essential in order to ensure collateral liquidity.

- Finally, it is incorrect to consider that there is a higher level of prudential safety offered by an entity acting as an operator of SSS as specified by the SFD. An intermediary acting as a custodian is subject to a stringent regulation and supervision by regulators and in general benefits from significantly higher financial resources as CSDs are most commonly credit institutions.

- Removing competitive distortions and risk concentration:

A SSS would have to offer global custody services in order to be able to operate a direct account for a CCP. Out of 20+ EU SSS, only 2 are capable of providing such services, which give them through the current wording of Article 47.3 a monopolistic advantage. In addition, such concentration of risk on only two entities is undesirable and should be discouraged by providing for more options and a levelling the playing field among the European CSDs. This should conduct the Commission to allow CCPs to have recourse to custodians in order to limit concentration risks and to ensure a fair competition with competitive prices.

### **Question 2.10: Additional stakeholder feedback**

- (i) Are there any significant ongoing impediments or unintended consequences with respect to any requirements or provisions under EMIR and not referenced in the preceding questions that have arisen during implementation?

Yes.

- (ii) If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?

### **Discriminatory disintermediation of delegated reporting when reporting entity is not the clearing broker**

EMIR framework requires that the CCP price be reported to the TR. Entities providing delegated reporting who at the same time are not clearing the trade do not have difficulty accessing the final price established at the level of the CCP (likewise, the methodology for the calculation of the IM as well as the segregation mode at the CCP remains unknown to the provider of delegated reporting causing problems to report correct data for the individual trade). This regulatory framework disintermediates delegated third party reporting providers and clearly favours delegated reporting by clearing brokers. By the same token, the impeded access to the CCP information seriously impacts on the quality of portfolio valuation performed by third party providers, e.g. by asset administrators.

### **Diverging interpretation and implementation by the national competent authorities:**

We re-iterate that the practical implementation of EMIR has consistently suffered from diverging interpretation and implementation by the national competent authorities, which gave rise to divergent industry practices and in consequence led to operational difficulties and compliance problems for market participants. We urge the European Commission to ensure more convergence and to limit implementation discretions across the Member States, and to ensure for a speedier resolution of questions arising from national divergences.

Apart from the most notorious aspects such as the definition of “derivative” versus “spot contract”, another example is found in the field of indirect clearing: it is unclear whether clients facilitating indirect clients with indirect clearing access must propose a segregation at the CCP level to the indirect clients. The process to eventually provide an answer to this problem though ESMA Q&As was laborious and very time consuming and kept the industry in a limbo for a considerable period of time.