FÉDÉRATION BANCAIRE FRANÇAISE

Paris, September 2, 2016

ESMA's CONSULTATION PAPER ON THE CLEARING OBLIGATION FOR FINANCIAL COUNTERPARTIES WITH A LIMITED VOLUME OF ACTIVITY

FBF's ANSWERS

Please find hereunder the French Banking Federation's ("FBF") answers to the queries raised by ESMA in its consultation paper on the clearing obligation for financial counterparties with a limited volume of activity.

Executive summary:

While a number of regulatory issues still need to be significantly changed before clearing members will be able to offer their clearing services to a wider public, such as (1) the leverage ratio and (2) indirect clearing arrangements for OTC derivatives, we would like to emphasize that for clearing members the cost of clearing will still remain the decisive factor in developing a sustainable client clearing business.

Clearing costs often make it economically unviable for category 3 clients to clear, and for Clearing Members to offer clearing services to clients with low OTC derivatives activity.

Therefore, we are of the opinion that the lack of access to clearing is not a timing issue but rather a cost issue. Thus a mere delay of the clearing obligation for category 3 clients will in itself not bring about a solution. Alternative solutions for category 3 clients are worth exploring instead.

However and taking into account the difficulties small category 3 clients may experience in building their clearing set-up, we support the proposal to extend the phase-in period for the clearing obligation for these counterparties. Indeed, while reiterating that the proposed extension does not solve the underlying problems, we recognize that the said extension of the phase-in period is necessary to allow for the regulatory amendments / reliefs to both EMIR and CRR provisions reflecting our concerns on the indirect clearing of OTC derivatives and the leverage ratio (see our answers on Questions 2 and 5).

Responses to the Consultation Paper questions:

Question 1: *To which category of counterparties does your organization belong: (1) in the context of the 1st Commission Delegated Regulation on the clearing obligation and, (2) in the context of the 2nd Commission Delegated Regulation on the clearing obligation?*

In the context of the first and the second Commission Delegated Regulations on the clearing obligation, the majority of the FBF's members, notably those participating to the present answers to the ESMA's consultation, belong to Category 1 (clearing members).

Question 2: *If you offer clearing services, please provide evidence on the constraints that would prevent you from offering clearing services to a wider range of clients.*

The main constraints and issues referred to hereunder have been raised in the former answer to the Commission's consultation on EMIR's review (see FBF and AFTI's answer dated August 11, 2015).

1) Leverage Ratio:

The fact that today, the Leverage Ratio does not recognize the exposure reducing effect of initial margin posted by clients to banks serving as clearing members, overstates the Leverage Ratio and disincentives clearing members from offering client clearing services. We welcome therefore the initiative of BCBS to further analyze the impact of the Leverage Ratio on client clearing.

2) Indirect clearing of OTC derivatives:

The amended RTS on indirect clearing of OTC derivatives published in May still raise a number of issues that challenge the set-up of indirect clearing services:

(i) The fact that those that choose to offer indirect clearing will need to make it available to all clients on the basis of objective criteria and reasonable commercial terms is not warranted, neither from a prudent risk management point of view nor from a cost perspective;

(ii) Porting requirements of end-clients' positions and collateral, as well as the distribution of liquidation proceeds to be paid directly to indirect clients ("*leapfrog payments*") for GOSAs ("*gross omnibus segregated accounts*") still pose significant legal and operational uncertainty.

3) Cost:

The mere cost of onboarding makes the setup of client clearing and indirect clearing for customers with limited derivatives activity as good as economically unviable, both for Category 3 clients as well as for the clearing members providing the services.

Question 3: *Have you already established clearing arrangements (1) for interest rate swaps? (2) for credit default swaps? If not, please explain why (including the difficulties that you may be facing in establishing such arrangements) and provide an estimation of the time needed to finalize the arrangements.*

Certain of our members have currently established clearing relationships in interest rate derivatives and credit default swaps, though in certain cases these do not cover all EU CCPs. These relationships include counterparties of categories 1, 2 and 3, though it should be stressed that widespread the coverage of category 3 counterparties is not currently established.

We note that our members do not have indirect clearing arrangements in place for OTC derivatives, for the reasons mentioned above (see Question 2).

Question 4: *Please provide information and data you may have that could complement this analysis on the level of experience and preparedness of financial counterparties with CCP clearing.*

Our members informs us that certain clients such as large global asset managers (whose individual funds fall within category 3 clients) have already put in place the mechanisms to ensure their readiness for the clearing mandates. These counterparties have assembled project teams, completed the clearing brokers' selection process and are now finalising negotiations and on-boarding. Several have completed the process for at least one clearing broker and are now adding further brokers.

However, we find that essentially 2 types of clients are not yet ready:

(i) smaller, less sophisticated asset managers are not yet scaled to implementing clearing and have been waiting on the side lines for the last 3 years;

(ii) small regional banks, with low volumes of OTC derivatives activity, which are from a clearing broker's perspective uneconomical to on-board.

Question 5: *Do you agree with the proposal to keep the definitions of the categories of counterparties as they currently are and to postpone the date of application of the clearing obligation for CAT3? If not, which alternative would achieve a better outcome?*

We agree to keep the definitions of counterparties unchanged as well as to postpone the clearing obligation for category 3 counterparties.

However, we would like to emphasize again that a delay of the clearing obligation for category 3 counterparties is not a sufficient solution to promoting widespread access to central clearing, as access to clearing is not solely a matter of timing. A delay might be a disincentive for smaller counterparties to pursue clearing access in the near-term, and it will not provide the necessary incentive for clearing members to set up wider clearing arrangements. Moreover it means that clearing members will have to remain in "*project mode*" for their clearing platforms for a prolonged period of time from a cost/benefit point of view.

That is why we suggest exploring alternative solutions for category 3 counterparties.

It is worth noting that, in the United States, the CFTC decided to exempt small financial institutions (i.e. having total assets which do not exceed $ 10 billion) from the definition of "*financial entity*" referred to in the Dodd-Frank Act ("DFA"); they are accordingly eligible for the end-user exception. When entering into non-cleared swaps, these entities (i) shall be exempted from clearing requirements when such transactions are used to hedge or mitigate their risks and (ii) will also qualify for an exemption from initial and variation margin requirements. In other words, the US regulators take into account the size of a financial institution to decide whether the latter must be subject to mandatory clearing and margins rules.

Our members consider that the European Union should also consider a legal regime adjusted to small financial counterparties. Conversely to the United States, this specific regime should primarily be risk based, rather than exclusively based on the size of the entities. Pursuant to this scheme, we propose small financial entities to be entitled to apply for a regulatory exemption from the clearing and initial margin requirements subject to the conditions that (i) their derivatives activity remains limited and consistent with their commercial activity and that (ii) their exposures are adequately monitored, reported to their supervisor and possibly subject to a cap . Those financial entities should be subject to variation margins.

In addition, as explained here above, we also suggest the European regulators use the contemplated phase-in period (2 years) to amend the EMIR provisions covering the indirect clearing regime, on the basis of our concerns and claims.

Last remark: we draw to your attention that a 2 year-postponement of the clearing obligation for category 3 counterparties would imply, absent a postponement of such obligation for category 4 counterparties that the latter would be subject to this constraint prior to category 3 counterparties. This situation would appear inconsistent with the Legislators' objectives.

Question 6: *Do you agree with the proposal to modify the phase-in period applicable to CAT3, by adding two years to the current compliance deadlines?*

As mentioned above, we support the proposal to extend the phase-in period for the clearing obligation for the category 3 counterparties, but we consider that a delay will in itself not bring about a solution.

Question 7: *Do you agree with the proposal to modify the three Commission Delegated Regulations on the clearing obligation at the same time?*

We would agree to develop an alternative solution as mentioned here above (see Question 5), i.e. setting up a specific legal regime adjusted to small financial counterparties.