EACH response to the European Commission public consultation on Regulation (EU) no 648/2012 on OTC derivatives, central counterparties and trade repositories

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Introduction

The European Association of CCP Clearing Houses (EACH) represents the interests of Central Counterparties (CCPs) in Europe since 1992. EACH currently has 20 members from 16 different European countries and is registered in the European Union Transparency Register with number 36897011311-96.

EACH welcomes the opportunity to provide input to the European Commission public consultation on Regulation (EU) no 648/2012 on OTC derivatives, central counterparties and trade repositories.

Question 1.1 - CCP Liquidity

Article 85(1)(a) states that: "The Commission shall ...... assess, in cooperation with the members of the ESCB, the need for any measure to facilitate the access of CCPs to central bank liquidity facilities".

There are no provisions under EMIR facilitating the access of CCPs authorised under EMIR to additional liquidity from central banks in stress or crisis situations, either from the perspective of the members of the ESCB or from the perspective of CCPs. However, it is recognised that in some member states, CCPs are required to obtain authorisation as credit institutions in accordance with Article 6 of Directive 2006/48/EC. Such authorisation creates access to central bank liquidity for those CCPs. On the other hand, other member states do not require CCPs to obtain such an authorisation.

Question 1.1.i - Is there a need for measures to facilitate the access of CCPs to central bank liquidity facilities?

Yes, EACH members believe there is a need for measures to facilitate access of CCPs to central bank liquidity facilities without a need for them to hold a banking licence. EACH also supports the wider access of CCPs to deposit accounts at central banks. Our views on these subjects are detailed in the next answer.

Question 1.1.ii - If your answer is yes, what are the measures that should be considered and why?

<u>**Access to central bank liquidity**</u>

EACH members support the possibility for CCPs to access central bank liquidity in order to promote the safety and efficiency of the markets. EMIR requires that CCPs have access to necessary credit lines or similar arrangements in order to perform its services and activities. CCPs can obtain these either from central banks or commercial banks. CCP access to central bank liquidity is currently not implemented consistently across the EU. Access to central bank money usually requires a banking license. Providing all CCPs across the EU with harmonised access to central bank liquidity creates not only a level playing field but also ensures an alternative source of liquidity for the CCP.

We believe that a banking licence should not be necessary to grant access to central bank liquidity. The access should include access to intraday and overnight facilities. The precondition for granting access should be the EMIR authorisation of EU CCPs.

EACH believes that **a change to the EMIR provisions is not necessary if all central banks within the EU agree** to providing access to such liquidity to the CCPs in their jurisdiction, as a complement to the objectives of EMIR. We understand that the final decision to grant access to central bank liquidity lies with the central bank.

EACH would like access to central bank liquidity to be seen as an additional tool, not mandatory under EMIR, a pre-requisite for authorisation or recognition or seen as a proxy for a liquidity deficit should a CCP not have access.

EACH believes that access to central bank liquidity should also be promoted as a global standard for CCPs domiciled outside of the EU.

Deposit account at central banks

EACH members consider that **CCPs should have access to accounts at central banks in order to deposit cash they receive as margin requirements and default fund contributions**. This approach would assist CCPs in limiting their exposure to commercial banks and comply with the EMIR rule under which no more that 5% of cash collateral, calculated over an average period of one calendar month, can be deposited on an unsecured basis. Notwithstanding this, EACH believes that the **requirement under Article 45.2 of the EMIR RTS 153/2013 for CCPs to reinvest no less than 95% of cash collateral in highly liquid financial instruments needs to be reassessed** in light of decreasing liquidity in short term financing instruments. EACH would support the creation of a technical working group between the public authorities and the industry to perform the technical reassessment of these provisions. Therefore it may be appropriate to allow CCPs to have further tools in order to reduce reliance on having to keep cash available to meet cash demands.

Question 1.2 - Non-Financial Firms

- No EACH comments.

Question 1.3 - CCP Colleges

Article 85(1)(c) states that: "The Commission shall….assess, in the light of experience, the functioning of the supervisory framework for CCPs, including the effectiveness of supervisory colleges, the respective voting modalities laid down in Article 19(3), and the role of ESMA, in particular during the authorisation process for CCPs."

In order for a CCP established in the Union to provide clearing services, it must obtain authorisation under Article 14 of EMIR. EMIR introduced a college system for the granting of such authorisation, which has, to date, been used for the process of authorisation of sixteen CCPs. The College comprises members from relevant competent authorities, relevant members of the European System of Central Banks and ESMA.

Question 1.3.a - What are your views on the functioning of supervisory colleges for CCPs?

EACH generally welcomes the establishment of the EMIR supervisory colleges as a means of harmonising the way CCPs are authorised in the EU. Based on the experience of EACH members, gained through their authorisation process as well as the process to extend their service and activities and apply changes to improve their risk models, **we believe that there are some areas in which the functioning of the colleges could be improved**. These areas are detailed in the next answer.

Question 1.3.b - What issues have you identified with respect to the college system during the authorisation process for EU CCPs, if any? How could these be addressed?

EACH believes that the CCPs' ability to innovate through the launch of new products and the improvement of risk management models could be improved. We would request that **the process for extending activities and services described in EMIR Articles 15 and 17 and the provisions regarding the authorisation of changes to a CCP's risk management models under Article 49 be streamlined in order to achieve a more efficient capital markets union in the EU**. Our proposals are detailed below.

<u>EACH specific comments on Article 15 (Extension of activities and services), Article 17 (Procedure for granting and refusing authorisation) and Article 49 (Review of models, stress testing and back testing)</u>

- **Governance - Overlapping verifications** - EACH believes that the current process to extend activities or services (Articles 15 and 17) or to authorise an enhanced version of the CCPs' risk models (Article 49) can sometimes lead to the duplication of verifications. **In order to address this concern, EACH proposes**:
  - To clearly define the role of each regulator within the procedure. It is our understanding that the role of the different authorities is as follows:
    - **National Competent Authority (NCA)**: Responsible for the supervision of the CCP;
    - **College**: Responsible for the consistent application of the EMIR rules; and

    - **ESMA**: Responsible for discharging the college of its responsibility for the consistent application of the EMIR rules.
  - To enhance the transparency and avoid bottlenecks in authorisations, EACH suggests that the dates of college meetings are communicated to CCPs.
  - To ensure the compliance with expected deadlines for the college to provide its opinion.

EACH specific comments on Article 15 (Extension of activities and services) and Article 17 (Procedure for granting and refusing authorisation)

- **Timing** – EACH considers that the timing to authorise the extension of activities and services is unnecessarily long. Based on the experience of EACH members, from the onset as of which the CCP submits its application to the NCA until the college delivers an opinion, it can in some circumstances take a CCP close to or longer than one year to obtain the approval of the extension of activities or services.

  In addition, it is important that authorities differentiate the processes of authorisation and extension. The process of extension should only focus on the new product/service. In practice however, some NCAs have required the CCP to submit all the documents governing its functioning, naturally followed by a thorough analysis of the detailed material which was already undertaken in the context of the original authorisation.

  In order to address this concern, EACH proposes:
  - The application of **one clear and public procedure** equally across all CCPs and jurisdictions in the EU, which will help CCPs to streamline their business strategy and prioritise their product launches/developments.
  - The assessments by the competent authorities should **differentiate between the process of extension and that of authorisation**. Authorities should focus on those elements of an additional service or activity which are *new* to that service or activity.
  - The publication of the list of criteria used to assess the applications under Articles 15 and 17.
  - The introduction of a **timeframe for the authorisation or extension of activities which is shorter than the current six months**. This timeframe would ensure that CCPs develop efficiently and do not face a competitive disadvantage with regard to CCPs located outside of the EU.

EACH specific comments on Article 49 (Review of models, stress testing and back testing)

- **Legal certainty around changes deemed 'significant' under Article 49** - EACH members are committed to continuous innovation in order to provide state-of-the art risk management practices. According to EMIR Article 49, a CCP must obtain the validation of ESMA and its competent authority before adopting any 'significant' change to its risk models and/or parameters. In addition, changes should be subject to the opinion of the college.

When improving their risk models, **CCPs have experienced difficulties regarding the interpretation of 'significant' change under Article 49.** In certain cases, *any* change to risk models and/or parameters has been considered 'significant', including those that require the approval of the CCP's Risk Committee as well as those that *only* require the CCP's Risk Committee to be informed. If any change is deemed 'significant', the ability for a CCP to introduce changes to risk models would be hampered. For example EACH would not expect a competent authority to consider 'significant' the introduction of one additional scenario to the stress test methodology, where the CCP may already be using some 150 scenarios. A requirement to obtain approval in this case would hamper the ability of the CCP to make innovative changes to enhance its risk management practices

In order to address these concerns, EACH requests clarification with regard to:

- **A list of indicative criteria** to determine whether a change is deemed 'significant'. The factors considered when determining any material changes (Article 49) to a CCP's existing risk management framework should be disclosed by regulators to CCPs.
- **Changes which are not deemed 'significant'** should require an ex-post control by the national competent authority, rather than an ex-ante approval.
- **The authority that is responsible** for determining whether a change is deemed 'significant' based on the list of criteria above. In our view, further to the provisions of Articles 49 and 19, the authority responsible for initially deeming a change 'significant' should be the NCA.
- **A clear timeframe** for the responsible authority to decide on the qualification of the change.
- **A clear description of the validation process**, including the order and timeframe in which the independent validation, the validation by the NCA and ESMA as well as the college opinion, should occur. In our opinion, the ESMA validation referred to under Article 49 should be an annual ex post check to confirm that the NCA has properly carried out its review and addressed all relevant issues with regard to the CCPs' models, rather than an ex-ante approval process.

A harmonised and transparent approach across the EU regarding changes deemed 'significant' would foster innovation across the EU and would also be beneficial to CCPs outside of the EU that apply for recognition.

We are of the opinion that **a change to the EMIR provisions is not necessarily needed to implement the above mentioned changes**. We would rather advocate for a consistent and transparent approach which is subject to an accurate timetable and provides clarity around the role of each regulator and the way to discharge the responsibility for the decisions to approve changes under Article 49.

- **Repetition of assessment** – The assessments currently performed by some regulators lead to the repetition of assessments which may not be directly related to the improvement of the risk models proposed and which had already been approved by authorities during the original authorisation of the CCP.

Question 1.4 - Procyclicality

Article 85(1)(d) states that: "The Commission shall....assess, in cooperation with ESMA and ESRB, the efficiency of margining requirements to limit procyclicality and the need to define additional intervention capacity in this area."

CCPs authorised in the Union must take into account potential procyclical effects when calculating their margin requirements. The specific factors that must be considered to avoid disruptive movements in margin calculations are provided for under Article 41 EMIR and Article 28 of Commission Delegated Regulation (EU) No 153/2013.

Question 1.4.a.i - Are the requirements under Article 41 EMIR and Article 28 Regulation (EU) No 153/2013 adequate to limit procyclical effects on CCPs' financial resources?

EACH believes that the existing **requirements to limit the procyclical effects on CCPs' financial resources could be enhanced to adequately cover all markets and products**. Regardless of the tool used to mitigate procyclicality, the final objective of adequate risk management should be targeted rather than the means of achieving it.

Question 1.4.a.ii - If your answer is no, how could they be improved?

EACH's members look to establish margin requirements that are necessarily prudent, while not being overly procyclical. In addition to the options permitted under Article 28 of the EMIR RTS, CCPs should utilise a variety of tools to manage procyclicality, depending on the product and the asset class.

The current procyclicality tools are not optimal for example for managing procyclicality for products that demonstrate significant changes in price and volatility during certain times of the year (seasonality). Failing to allow for CCPs to implement tools to primarily manage the procyclical risk of seasonal products in this manner may create additional risk, especially where seasonal factors outweigh historical volatility over a longer time horizon. New tools to address seasonal volatility represent the most effective way for addressing the procyclical nature of certain products and this option is unavailable under Article 28 of the EMIR RTS. We believe it is not feasible to include adequate procyclicality tools for every product that CCPs clear. We would therefore recommend initiating a **working group to develop framework principles with regard to how to measure and adequately control procyclicality**.

Additionally, it is also important to note that similar procyclicality provisions are not included in other pieces of legislation outside of the EU. This creates an unlevel playing field for European CCPs. EACH would **support a global approach to address procyclicality**.

Question 1.4.b.i - Is there a need to define additional capacity for authorities to intervene in this area?

EACH believes that the current standards in place allow CCPs as risk management experts to address procyclicality as it applies to the risks inherent to certain products, but are restrictive in nature and do not allow for CCPs to have the necessary flexibility to efficiently address the procyclical nature of all the products they clear and markets they serve.

Question 1.4.b.ii - If your answer is yes, what measures for intervention should be considered and why?

As explained above, CCPs have many tools available to them in managing procyclicality and a CCP should be able to use those measures as their primary tool for managing procyclicality. Therefore we do not believe that further intervention is necessary and that in fact CCPs should be allotted additional flexibility to prudently manage procyclicality.

Question 1.5 - CCP Margins and Collateral

Article 85(1)(e) states that: "The Commission shall....assess, in cooperation with ESMA the evolution of CCP's policies on collateral margining and securing requirements and their adaptation to the specific activities and risk profiles of their users."

Collateral collected by way of initial and variation margin requirements is the primary source of financial resources available to a CCP. Title IV of EMIR and Commission Delegated Regulation (EU) No 153/2013 provide detailed requirements for the calculation of margin levels by CCPs as well as defining the assets that may be considered eligible as collateral.

Question 1.5.a.i - Have CCPs' policies on collateral and margin developed in a balanced and effective way?

No. EACH has strong **concerns about the portfolio margining provisions included in Article 27 of the EMIR RTS 153/2013 on CCP requirements**.

Question 1.5.a.ii - If your answer is no, for what reasons? How could they be improved?

EACH proposal for Article 27.1 and 27.3 of the EMIR RTS 153/2013

The current regulation does not allow financial instruments to be portfolio margined together unless their correlations are significant, reliable and resilient under stress. EACH believes that choosing correlations as a metric to measure the adequateness of the margin at a portfolio level can be misleading for portfolio margin models.

EACH would therefore support broadening the current regulation to allow portfolio margining to take place for instruments which do not meet these statistical criteria, provided:

- The CCP is able to demonstrate that its margin model is sufficiently robust to prudently model the risk of the financial instrument even when correlations may not be significant nor reliable. The main tool to accomplish this is back testing, including 'micro back tests', which are tests at the small portfolio level (e.g. outright positions and commonly traded spreads), in addition to tests at client or clearing member level.
- The CCP can demonstrate that the group of financial instruments to be portfolio margined can be hedged as one portfolio of risk during a default and/or auctioned in a reasonable period of time (as applicable), consistent with the liquidation process.

EACH proposal for Article 27.4 of the EMIR RTS 153/2013

EACH would also like to make it clear that, provided the above conditions are met, a CCP may recognise greater than 80% of the offsets provided by its model. If the above conditions are not met then the maximum amount of offsets that a CCP could provide would be limited to 80%.

EACH proposal for Article 49 of the EMIR RTS 153/2013

To require the CCPs to provide evidence that the target confidence level is achieved overall for aggregated results on portfolio level.

In light of the risk management benefits that the above suggestions would bring to the market, EACH believes that they could be addressed through a modification of the existing provisions in Article 27 of the EMIR RTS 153/2013. We believe that a full review of the EMIR legislation is neither necessary nor desirable, as it would likely take much longer to implement than the proposed changes to the RTS.

Our detailed views on portfolio margining are included in the **attached paper 'Appendix 1 - EACH views on portfolio margining'**.

Question 1.5.b.i - Is the spectrum of eligible collateral appropriate to strike the right balance between the liquidity needs of the CCP and its participants?

No.

Question 1.5.b.ii - If your answer is no, for what reasons? How could it be improved?

In light of the liquidity needs of CCPs and the diversity of financial instruments cleared by CCPs, EACH supports an **extension of the current list of highly liquid financial instruments that represent eligible collateral**.

As an example, we would like to highlight the case of **warrants** used when trading some metal contracts. Warrants are used for the settlement of a trade to enable the delivery of the underlying metals. They are held in a system operated under strict rules and procedures within a well-defined legal framework. Warrants are by their nature very liquid as they are the means of delivery of the underlying metals traded on the exchange. The CCP already has an excellent knowledge of the risks relating to these assets. The CCP is also well positioned to liquidate these assets in the event of a default as it is already operating within the metal trading market.

For these reasons, EACH would **support the acceptance of warrants as collateral under Article 46(1) as highly liquid instruments for the clearing of metal contracts** and therefore extend the list in Annex I of the EMIR RTS 153/2013 to include warrants.

Question 2.1 - Definitions and Scope

- No EACH comments.

Question 2.2 - Clearing Obligations

Under EMIR, OTC derivatives transactions that have been declared subject to a clearing obligation must be cleared centrally through a CCP authorised or recognised in the Union. ESMA has proposed a first set of mandatory clearing obligations for interest rate swaps which are yet to come into force. Counterparties are therefore in the process of preparing to meet the clearing obligation, to the extent that their OTC derivatives contracts are in scope of the requirements.

Question 2.2.a.i - With respect to 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?

- No EACH comments.

Question 2.2.a.ii - If your answer is yes, please provide evidence or specific examples. How could these be addressed?

- No EACH comments.

Question 2.2.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.

Question 2.2.b.ii - If your answer is yes, please provide evidence or specific examples. How could these be addressed?

EACH members support a **prompt implementation of the clearing obligation for those classes of standardised OTC derivatives for which a clearing obligation has been proposed**[1]. The clearing obligation is one of the key provisions in EMIR in order to ensure a safer and more efficient OTC derivatives market for the benefit of market participants and the economy as a whole. We would therefore encourage ESMA and the European Commission to swiftly finalise the regulatory process for the proposed clearing mandates and ensure that this also happens going forward for future proposed mandates.

[1] Clearing obligation no1 for IRS in G4 currencies; no2 for certain CDS; no 4 for IRS in certain EEA currencies.

Because the European clearing obligation is presently expected to come into effect in H1 2016, we would encourage the European Commission and ESMA to complete the authorisation and recognition process for CCPs from equivalent third country jurisdictions sufficiently in advance of that date so as to avoid the bifurcation of liquidity in OTC derivatives that will be subject to the obligation.

EACH would also welcome **clarification on the process to be followed in the decision not to impose or to remove/suspend clearing obligations** on a class or sub-class of OTC derivatives.

Question 2.3 - Trade reporting

Mandatory reporting of all derivative transactions to trade repositories came into effect in February 2014. The Commission services are interested in understanding the experiences of reporting counterparties and trade repositories, as well as national competent authorities, in implementing these requirements. As noted above, ESMA recently conducted its own consultation on amended versions of these standards. This consultation does therefore not seek any views with respect to the content of either Regulation No. 148/2013 and Regulation No. 1247/2012 nor the proposed amended versions.

Question 2.3.i – Are there any other significant ongoing impediments or unintended consequences with respect to meeting trade reporting obligations in accordance with Article 9 of EMIR?

Please note that one EACH member does not support the answer to question 2.3.

EACH understands that the purpose of the EMIR trade reporting provisions is to ensure that information on the risks inherent in derivatives markets are stored centrally and easily accessible to ESMA, the relevant competent authorities, the European Systemic Risk Board (ESRB) and the relevant central banks of the ESCB. EACH believes that there are still certain issues which should be addressed to achieve that purpose more efficiently.

EACH also notes that the various forms of guidance issued by ESMA have been helpful in addressing on-going reporting issues with a way to significantly improve the trade reports of various market participants subject to the reporting obligation set forth in Article 9 of EMIR.

However, in order to ensure that the information reported to trade repositories provides the various regulatory authorities with accurate view of systemic risk, EACH supports a **higher degree of legal certainty with regard to such guidance.** This legal certainty should be achieved through the development of a complete and comprehensive set of RTS which details precise reporting requirements rather than attempting to add clarity through different versions of non-legally binding Q&A or information provided by ESMA to Trade Repositories.

Additionally, in light of the significant development costs and investment already made by CCPs, clearing members and market participants in meeting trade reporting requirements,

EACH would request that **sufficient and prescribed time is allowed to implement any changes made to the reporting requirements** included in the RTS.

Question 2.3.ii - If your answer is yes, please provide evidence or specific examples. How could these be addressed?

Reporting inconsistencies

EACH would encourage the Commission **to align the trade reporting requirements under EMIR with the reporting requirements under MIFID II and REMIT** in order to ensure greater consistency and data accuracy.

An example of the incongruity between EMIR and REMIT is the 'Delivery point or zone' field for commodities contracts. ESMA's Validation Table of 27/04/2015 states that TRs shall implement a validation on this field such that, '[w]hen populated, this field shall contain an EIC code as specified in the EIC Area Codes (Y) code list and pertaining to a delivery point within the European Union.' However, ACER's Transaction Reporting User Manual ('TRUM') instructs counterparties reporting under REMIT to populate 'Delivery point or zone' with an EIC (Z) code when gas can be delivered at the relevant interconnection point. Therefore, a TR would be required to reject the trade under EMIR if the counterparty rightfully reported a Z code under REMIT.

An example of the incongruity between EMIR and the MIFIR proposals for market data reporting is the proposed requirement under MIFIR which requires decreases and increases in notional amount to be reported as new transactions. However, counterparties reporting under EMIR report this as modifications to the original contract.

Complexity of reporting requirements

EACH would suggest that the Commission review the following areas in order to ensure more efficient and effective reporting:

- **Scope of Article 9 (Reporting requirements):** EACH has concerns about the reporting requirements for Exchange-Traded Derivatives (ETD) contracts. A complete record of all ETD contracts is already available from CCPs. The sheer number of ETD transactions has resulted in significant challenge for regulators and trade repositories to consume the data in a meaningful way. The requirement to report ETD contracts represents a major competitive disadvantage for European reporting entities compared to other jurisdictions like the US and is out of the scope of the original G20 mandate agreed in Pittsburgh.
- **Single-sided transaction reporting:** EACH supports single-sided reporting of cleared transactions, rather than the current requirement for double-sided reporting. Single-sided reporting of derivatives would (i) enhance data quality by requiring the best-positioned counterparty to report and validate the data; (ii) avoid the additional effort of reconciliation of reports and alignment of Unique Trade Identifiers (UTI) between counterparties; and (iii) align EU legislation with other jurisdictions. It would also simplify reporting of collateral held in relation to cleared transactions. Single-sided reporting would favour that the reporting responsibility is clearly allocated to the CCP

which is known throughout the financial services industry as holding the legally binding 'golden record' of a contract.

Standards for new fields

Using existing standards would avoid unnecessary translation of existing clear trade confirmation data into new concepts. Prescribed standards provide no additional increase in the data quality or validation of data. For instance, FIXML and FpML have a practical way to record (e.g. notional schedule) and trying to introduce the concepts of original and current notional amount would make their prescribed fields unnecessarily different and ambiguous.

Alternative codes where LEI is not available

A number of market participants who have a reporting obligation (e.g. private persons) may not be able to obtain an LEI code. EACH advocates the use of BIC or client code where LEI is not available.

Reporting of Initial margin/variation margin for ETD trades

EACH believes that **ESMA's recent proposal to replace posted collateral by initial margin posted and variation margin posted does not achieve the aim of the reporting requirement.** For ETD contracts, variation margin, which is a cash transfer from the participant which has made a loss to the participant which has made a profit, is not considered as 'collateral' held against the risk position. In order to calculate total systemic risk, **ESMA should keep the existing fields and add initial margin required to be able to evaluate the risk exposure against posted collateral.**

Process for change of reporting requirements

While the ESMA Q&A provides useful clarifications, EACH is concerned about the legal certainty provided by the Q&A and their consistency with previous Q&A or guidance provided by the national competent authorities. All changes to the reporting requirements will require software changes and produce additional costs and efforts to CCPs, TRs, participants and their clients.

EACH would also welcome a review of timing of current changes. It appears that enhanced Level 2 validations are being introduced before any feedback on ESMA's review of trade reporting or the Commission's EMIR review. For further details see 'Appendix 2 - EACH views on validation issues' attached.

Question 2.4 - Risk Mitigation Techniques

- No EACH comments.

Question 2.5 - Exchange of Collateral

- No EACH comments.

Question 2.6 - Cross-Border Activity in the OTC derivatives markets

OTC derivatives markets are global in nature, with many transactions involving Union counterparties undertaken on a cross-border basis or using third country infrastructures. EMIR provides a framework to enable cross-border activity to continue whilst ensuring, on the one hand, that the objectives of EMIR are safeguarded and on the other hand that duplicative and conflicting requirements are minimised.

Question 2.6.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?

- No EACH comments.

Question 2.6.a.ii - If your answer is yes, please provide evidence or specific examples. How could these be addressed?

- No EACH comments.

Question 2.6.b.i - Are there any provisions within EMIR that create a disadvantage for EU counterparties over non-EU entities?

Yes, EACH believes that **there are some provisions within EMIR that currently create an unlevel playing field for EU counterparties over non-EU entities**. In the opinion of EACH members, consistency and harmonisation of policy initiatives to avoid regulatory arbitrage and to ensure a level playing field across CCPs globally is the objective that would need to be met. This is particularly the case for CCPs clearing derivatives products, which is considered a global asset class. In the section below we detail the specific examples of the clearing obligation margin requirements and reporting of ETDs.

Question 2.6.b.ii – If your answer is yes, please provide evidence or specific examples. How could these be addressed?

Implementation of the clearing obligation

In the global derivatives market, the fact that the clearing obligation has already been implemented in jurisdictions like the US **puts the EU at a disadvantage**.

EACH members support a **prompt implementation of the clearing obligation for those classes of standardised OTC derivatives for which a clearing obligation has been proposed**[2]. The clearing obligation is one of the key provisions in EMIR in order to ensure a safer and more efficient OTC derivatives market for the benefit of market participants and the economy as a whole. In order to avoid any regulatory arbitrage between jurisdictions, we would therefore encourage ESMA and the European Commission to swiftly finalise the

[2] Clearing obligation no1 for IRS in G4 currencies; no2 for certain CDS; no 4 for IRS in certain EEA currencies.

regulatory process for the proposed clearing mandates and ensure that this also happens going forward for future proposed mandates.

Because the European clearing obligation is presently expected to come into effect in H1 2016, we would encourage the European Commission and ESMA to complete the authorisation and recognition process for CCPs from equivalent third country jurisdictions sufficiently in advance of that date so as to avoid the bifurcation of liquidity in OTC derivatives that will be subject to the obligation.

Margin requirements

Although margin standards for cleared CCP derivatives under EMIR and comparable legislation in other jurisdictions, such as the US Dodd-Frank or the Russian Regulation for CCPs (CBR Regulation 2919) are consistent with the PFMIs, they are not identical. Prudential rules (i.e. provisions on margin standards) in different jurisdictions may not satisfy an equivalence test if judged on a line-by-line basis.

Thus, **it is important to take a holistic, outcomes-based approach to assessing equivalence of margin standards to avoid weaker margin coverage for the CCP from clearing participants and end customers**. Weaker coverage could result in margin arbitrage for identical products offered by CCPs which offer cross-border services and potentially result in a flow of business currently cleared in one jurisdiction to other jurisdictions. This can be avoided through the authorisation of CCPs from jurisdictions that have equivalent margin standards.

The net result of a lack of harmonised international margin requirements would be to encourage the precise type of margin arbitrage that prudent regulators and clearing house operators have long and appropriately avoided.

Reporting of ETDs

The **requirements on trade reporting for CCPs are not consistent between EMIR, Dodd-Frank/CFTC and other jurisdictions**. EMIR requires all derivatives contracts (i.e. listed and OTC) to be sent to trade repositories, while the scope of the reporting provisions in Dodd-Frank and in the legislation in some other jurisdictions is limited to OTC derivatives contracts only.

Question 2.7 - Transparency

The overarching objective of the trade reporting requirement under EMIR is to ensure that national competent authorities and other regulatory bodies have data available to fulfil their regulatory mandates by monitoring activity in the derivatives markets.

Question 2.7.i – Have any significant ongoing impediments arisen to ensuring that national competent authorities, international regulators and the public have the envisaged access to data reported to trade repositories?

Please note that one EACH member does not support the answer to question 2.7.

Yes. As set out above, EACH believes that the reporting of ETD contracts, approach to double-sided reporting as well as unclear definitions of reportable fields constitute remaining impediments to effective and efficient data access.

Question 2.7.ii - If your answer is yes, please provide evidence or specific examples. How could these be addressed?

<u>Scope of Article 9 (Reporting Requirements)</u>
EACH has concerns about the additional systemic risk value provided by the requirement to report Exchange-Traded Derivatives (ETD) contracts. Regulated Markets in Europe are highly regulated by relevant competent authorities and transparent, and they proved their functioning during the financial crisis. A complete record of all ETD contracts is already available from CCPs and therefore ETD reporting does not seem to have a sufficient cost-benefit case. On the contrary, the sheer number of ETD transactions has resulted in significant challenge for regulators and trade repositories to consume the data in a meaningful way. In addition, the requirement to report ETD contracts represents also a major competitive disadvantage for European reporting entities compared to other jurisdictions like the US and is out of the scope of the original G20 Commitments made in Pittsburgh.

<u>Single-sided reporting</u>
EACH supports single-sided reporting of cleared transactions, rather than the current requirement for double-sided reporting. A hierarchy can be established in order to ensure reporting of each leg of the trade. Single-sided reporting of derivatives would: (i) enhance data quality by requiring the best-positioned counterparty (e.g. the CCP for CCP-CM trades) to report and validate the data; (ii) avoid the additional effort of reconciliation of reports and alignment of Unique Trade Identifiers (UTI) between counterparties; and (iii) align EU legislation with other jurisdictions, most notably the U.S. Single-sided reporting would minimise the number of reconciliation issues that may derive from different interpretations of the regulation in cases of double-sided reporting and will significantly streamline the financial and personnel resources currently expended by counterparties to resolve such data differences. Single-sided reporting would also simplify reporting of collateral held in relation to cleared transactions, rather than the current requirement for double-sided reporting. Single-sided reporting would favour that the reporting responsibility is clearly allocated to the CCP which is known throughout the financial services industry as holding the legally binding 'golden record' of a contract.

EACH believes that using single-sided reporting would be a more economical and effective way of ensuring data quality than requesting double-sided reporting. Then, the Clearing Member, or if delegation is preferred (e.g. to centralise reporting activities of many reporting entities), a regulated trading venue operator would provide the reporting. By definition the details of a trade confirmed or cleared on a regulated trading venue must be clear to the clearing member or the platform operator. The current issues with data quality do not therefore result from a different understanding of the trade characteristics but from a different understanding of how to translate them to the EMIR format. **This inaccuracy would be eliminated by having the clearing members or platform operators report single-sided and by providing clear reporting guidelines.** The data available to regulators and the public would be consistent.

Data definition

There are still a number of examples of data field for which there is no common understanding of how to populate the relevant fields for different types of derivative contracts and life-cycle events (e.g. notional, interest rate, mark-to-market, collateral). Additional clarity in the RTS would help ensure consistency of reporting thereby enhancing data quality.

Question 2.8 - Requirements for CCPs

Titles IV and V of EMIR set out detailed and uniform prudential and business conduct requirements for all CCPs operating in the Union. CCPs operating prior to EMIR's entry into force are required to obtain authorisation in accordance with the new requirements of EMIR, through the EU supervisory college process.

Question 2.8.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?

Yes. EACH believes that there are or will shortly be impediments or unintended consequences with respect to CCPs' ability to meet requirements in accordance with Titles IV and V of EMIR. Our concerns are detailed in the next answer.

Question 2.8.a.ii - If your answer is yes, please provide evidence or specific examples. How could these be addressed?

Bank guarantees

Non-financial participants may currently use bank guarantees as collateral for CCP clearing of power, gas derivatives and other commodities, without the guarantees being fully backed. This is possible further to the exemption of the EMIR requirement that bank guarantees must be fully backed by collateral. This exemption has been provided for a period of three years and will expire in March 2016.

EACH proposes to allow the use of bank guarantees without full backing, by **urgently extending the current exemption based on a thorough assessment of its impact on the market** and in the future removing section 2.1, point h) in Annex 1 in Regulation No 153/2013

(the EMIR 'Implementation Act'). A failure to do so would **shrink the currently transparent, centrally-cleared market and increase of costs for market participants while receiving a lower levels of protection.**

Our detailed arguments on the need to extend the current exemption beyond 2016 are included in the **attached EACH paper 'Appendix 3 - EACH views on bank guarantees'**.

Question 2.8.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?

EACH believes that the requirements of Titles IV and V are generally sufficiently robust to ensure appropriate levels of risk management and client asset protection with respect to EU CCPs and their participants. This is particularly the case of the requirement under Article 43 for CCPs to contribute some of its own capital to the waterfall before mutualisation (i.e. Skin in the game).

Given the central risk management role of CCPs, **the CCP operator is required to contribute some of its own capital to the waterfall before mutualisation**. This creates direct '**skin in the game**' for the CCP operator as an institution in the event that the losses of a member's default cannot be covered by the defaulter's own funds and must be therefore allocated to the CCP and mutualised across other members. Skin in the game is intended to incentivise the CCP operator to ensure it sets the margins at an appropriate level and maintains a robust default management process.

Skin in the game is a component of the default waterfall which demonstrates **alignment of the CCP's interests with those of its stakeholders**. With their own funds at risk immediately after the defaulter's are exhausted, the current requirement for the CCPs to contribute its own resources to the default waterfall provides the right incentives for the CCP to perform prudent risk management.

Any requirement for the CCP operator to contribute significant additional resources to the default waterfall and link them to the overall member exposure would fundamentally change the operator's risk profile, creating increased risk exposure to member default at the very time that the operator should be resilient in order to ensure continuity of the clearing service and stability of the market.

In the following answer we would like to express some views with regard to some other provisions included in EMIR.

Question 2.8.b.ii - If your answer is no, for what reasons? How could they be improved?

Investment policy

We believe that CCPs should be allowed to further diversify the range of secured investments detailed in Article 47 of EMIR and Article 43 of EMIR RTS 153/2013, as long as CCPs take an adequate risk-based approach towards the products they invest in, in line with the capital

requirements under the EMIR RTS 152/2013. As an example, CCPs' investment policies should be **extended to allow investments in money market funds (MMFs)** under certain conditions.

In the experience of some of our CCP members operating in the US, late in the day margin calls tend to be met largely in cash by US clearing members and therefore need safe, liquid and reliable outlets to invest securely the late cash-inflows. The prohibition under EMIR imposes material constraints on cross-border CCPs and can result in an increased risk profile if such CCPs are unable to locate high quality secured investment capacity for clients' and members' money. We would like to encourage the European Commission **to consider MMF as highly liquid financial instruments if they meet conditions** such as:

- The fund must be appropriately registered by its competent authority;
- The fund must be sponsored by authorised credit institutions as defined and regulated under CRDIV and CRR, an investment firm authorised under MiFID II and MIFIR, an alternative investment fund managed by AIFMDs authorised or registered in accordance with the AIFM Directive, or third country equivalent firms and institutions.
- The fund shall be required to redeem an interest and to make payment in satisfaction thereof by the business day following a redemption request;
- The assets held by the MMF should be of the type that the CCP is permitted to invest in pursuant to its approved investment policies and paragraph 1 of Annex II.

Investment portfolio

The investment portfolio should be exposed to low credit market and liquidity risk, and avoid restrictions such as the provision in Annex II para. 1 (c) of the EMIR RTS 153/2013 whereby 'the average time-to-maturity of the CCP's portfolio does not exceed two years'.

A CCP should take a risk based approach to its investment portfolio, managing the portfolio and its risk in accordance with the CCP's investment policy. Restrictions in terms of maturity do not necessarily reflect the risk profile of a CCP, and could lead to a suboptimal asset management for a CCP, including forcing a CCP to focus on maturity rather than on the actual liquidity and the investment diversity.

Even when the maturity condition is fulfilled, a high concentration in a given group of securities with a fixed interest level can generate higher risk of investment loss in case of an increase of interest. Article 4 of the EMIR RTS 152/2013 would require a CCP to hold more capital for an investment portfolio as inherent risk increases. Therefore, a higher diversification in the investment portfolio is desirable from a risk mitigation perspective.

For the above mentioned reasons we suggest reassessing the criteria under **Annex II of the EMIR RTS 153/2013 in order to ensure they focus on low credit, market and liquidity risk**. **In particular we suggest removing the requirement under para. 1(c) in Annex II of the EMIR RTS 153/2013** with regard to debt instruments sufficiently safe and liquid.

Hedging of interest rate exposure

The current provisions in Annex II paragraph 2 of the ESMA RTS No 153/2013 limit the CCPs' use of derivatives to hedge the risk arising from default management and the currency risk arising from liquidity management. **We would like the European Commission and ESMA to amend the current rule to also allow CCPs to use overnight index swaps (OIS) to hedge the interest rate exposure for their investment activity**. As required under EMIR, CCPs invest the cash collateral received by clearing members into highly liquid financial instruments. CCPs usually remunerate their members for cash margin posted by paying a certain amount of interest. In case of raising interest rates, EMIR-authorised CCPs have no options available to hedge the interest rate risk.

Concentration limits

We have concerns regarding to the provisions of Article 44.1 that limit 25% of credit lines to be provided by one member, or its parent undertaking or subsidiary. **We believe that concentration limits should rather depend on the characteristics of the CCP** (volumes and products cleared, number of clearing members, the degree to which a given CCP is actually dependent on credit lines in terms of its liquidity, etc.). The current provisions with regard to concentration limits are duplicated: in addition to the provisions of Article 44.1, CCPs should also comply with the provisions under Article 42 of the EMIR RTS 153/2013 which already cover CCP's exposure resulting from credit lines. That is why EACH believes the over-prescriptive concentration limit from Article 44.1 should be removed. It is therefore important for CCPs to ensure access to central bank liquidity as an additional resource.

Question 2.8.c.i - Are there any requirements for CCPs which would benefit from further precision in order to achieve a more consistent application by authorities across the Union?

- No EACH comments.

Question 2.8.c.ii - If your answer is yes, which requirements and how could they be better defined?

- No EACH comments.

Question 2.9 - Requirements for Trade Repositories

Titles VI and VII of EMIR set out detailed and uniform requirements for all trade repositories operating in the Union. Trade repositories operating prior to EMIR's entry into force are required to obtain authorisation by ESMA in accordance with the requirements of EMIR. To date, ESMA has authorised six trade repositories. ESMA is the primary supervisor for Union trade repositories and has the power to issue fines for non-compliance with the requirements of EMIR.

Question 2.9.i - Are there any significant ongoing impediments or unintended consequences with respect to requirements for trade repositories that have arisen during implementation of Titles VI and VII of EMIR, including Annex II?

Yes. EACH believes that having complete and clear guidance through the EMIR RTS would help trade repositories in the validation process.

Question 2.9.ii - If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?

Please note that one EACH member does not support the answer to question 2.9.ii.

At present, it appears that the implementation of EMIR provisions slightly varies from one trade repository to another (e.g. because each TR employs its own proprietary systems and controls, the values for the field price/percentage are sometimes completely different depending on the trade repository). Furthermore, TRs receive bilateral guidance from ESMA which does not always align with the markets' or the competent authorities' interpretations of the EMIR RTS. Additionally, the comments made around limiting scope of the reporting requirement to OTC derivatives and implementation of single-sided reporting would simplify the work of Trade Repositories.

Question 2.10 - Additional Stakeholder Feedback

In addition to the questions set out above, the Commission services welcome feedback from stakeholders on any additional issues or unintended consequences that have arisen during the implementation of EMIR which are not covered by those questions.

Question 2.10.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.

Question 2.10.ii - If your answer is yes, please provide evidence or specific examples. How could these be addressed?

'No action' regime

It has become apparent during the process of EMIR implementation that it would have been useful to be able to take advantage of a 'no action regime' in the same way as that operated by the US CFTC. In the review of EMIR it might make sense to evaluate the feasibility of such a tool.