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EU Regulatory update

Simon Puleston Jones

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Main areas of current work

Regulatory Capital / Leverage Ratio	EMIR Review and the ESMA Discussion Paper on Client Margin	MiFID II / MiFIR	Benchmarks	European Commission's Call for Evidence
Cross-border Regulation	CCP Risk / Recovery & Resolution	Benchmarks	Conduct / Market Abuse	
Securities Financing Transaction Regulation (SFTR)	Cyber-security / Technological Change	Capital Markets Union (CMU)		

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Regulatory Capital - CRD IV / CRR

Supporting FIA Global advocacy with members of the Leverage Ratio Working Group of the Basel Committee:

- Meetings with various central bankers in Europe regarding the impact on clearing members: **pushing for leverage ratio to be amended to recognise the exposure-reducing effect of segregated margin**

- Driving the above message home at the European Commission's public hearing on the EMIR Review and in almost all engagements with regulators, legislators and politicians

- Meetings with EBA and HM Treasury regarding the impact on commodity traders and energy companies

- Letter sent to European Commission to seek 2 year delay to the imposition of CRDIV on commodity traders and energy companies (aligned with the European Commission's view, who support the letter)

- More engagement needed with the banking team at the European Commission, who consider this issue to be a "perception problem" rather than any amendments being required to CRDIV

EMIR Review - timings

May 2015:	Simon Puleston Jones spoke at the European Commission's public hearing regarding the EMIR Review
June 2015:	Simon Puleston Jones chaired an industry roundtable in London with UK regulators/HM Treasury
August 2015:	FIA Europe replied to the European Commission's EMIR Review consultation
September 2015:	FIA Global responded to the ESMA Discussion Paper on Client Clearing
September 2015:	European Commission launched its "call for evidence" regarding conflicts/overlaps/underlaps in recent EU regulatory reform
October 2015:	FIA Europe and its members met with the European Commission to discuss FIA Europe's response to the EMIR Review consultation
Before end-2015:	European Commission to publish its views on the EMIR Review consultation responses
April 2016:	Clearing obligation for IRS in G4 currencies anticipated to commence for clearing members
2016:	European Commission expected to publish its proposals on amendments to the EMIR Regulatory Technical Standards – no changes anticipated at level 1

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EMIR Review

CCPs:

- Cash deposits held with a central bank in a currency other than the central bank's currency should count as part of the CCP's liquid resources
- The 95% reinvestment rule should apply across *all* cash held by a CCP, not on a per currency, per account, basis. EC should analyse whether a 95% threshold for reinvestment of overnight cash deposits is appropriate for all EU CCPs
- We encourage EU central banks, at all times and not just in stressed markets, to facilitate the acceptance of cash deposits from CCPs in all major currencies and to offer access to central bank liquidity facilities. The terms of such facilities should be more transparent. CCPs should not be required to be banks to have access to central bank facilities
- College system needs more transparency
- Clearing members should have greater input into CCP governance decisions
- More clarity needed on the process for extending EMIR authorisation
- Process to validate significant changes to risk models should be streamlined
- EMIR does not sufficiently address the amount of skin in the game required for each product cleared by the CCP; allocation of non-default losses; or replenishment of the CCP's default fund
- Various insolvency and property law conflicts impact segregation and portability
- Client should be required to confirm their choice of segregation models within 90 days, failing which the clearing member can opt to credit the client positions to its client omnibus account

EMIR Review

NFCs:

- Amend NFC+ calculation so that it is based on exposure, not gross notional; exclude intra-group transactions; and only include transactions entered into by a group company established in the EU or entered into by a non-EU group company with FCs/NFCs
- Apply a “reasonable commercial basis” exemption to portfolio hedges

Cross-border:

- Complete the Article 2(7), 13 and 25 third-country equivalence/recognition assessments and provide more transparency on the process

Clearing:

- Challenges of gaining access to clearing are largely driven by CRDIV / leverage ratio impact
- Indirect Clearing must remain *voluntary* to offer and EMIR should permit an opt-out of the leapfrog payment obligations where they give rise to insolvency/property law conflicts
- Frontloading: exclude future currencies and contracts from scope of frontloading
- Permit suspension of the clearing obligation if liquidity has significantly reduced
- Trades resulting from compression of bilateral trades should not be required to be cleared

EMIR Review

Reporting:

- Exempt ETD, failing which adopt single-sided *position* reporting for ETD
- Adopt single-sided *transaction* reporting for everything else
- Standardise UTI construction methodology in a way that works for both OTC and ETD
- Remove reporting obligation for NFC-

ESMA Discussion Paper on client margin under EMIR

We did not express a preference between 2 day net vs 1 day gross MPOR. We took a more holistic approach:

CPMI-IOSCO are assessing margining requirements at a global level – focus on ensuring that CCPs implement robust margin frameworks based on appropriate risk criteria, rather than prescribing specific standards for each element of their margin methodologies.

The regulatory framework for the calculation of client margin should:

- allow CCPs to use a MPOR that is appropriate to the relevant product in light of the CCP's default management objectives;
- not strictly distinguish between products based upon whether they are executed in the OTC market or on a regulated exchange; and
- not vary solely on the basis of the type of account structure

MiFID II / MiFIR

MiFID II / MiFIR goes live on 3 January 2017

Some notable successes as a result of our advocacy

Indirect clearing of ETD: ESMA to launch a consultation this month on its proposed amendments to EMIR (cleared swaps) and MiFIR (ETD) indirect clearing arrangement as a direct result of FIA Europe's advocacy

Straight-through processing: ESMA now proposes to exempt ETD from the pre-execution limit check requirements

Micro-structural issues: Many comments made by FIA Europe and FIA EPTA were accepted – the vast majority of the RTS accord with members' positions relating to investment firm and trading venue organisational requirements; market making arrangements; orders-to-transactions ratio; colocation and fee structures; tick size regime; and clock synchronisation. Main point outstanding is the extent to which third-country DEA users have to be authorised as an investment firm – ESMA see this as a level 1 issue.

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MiFID II / MiFIR

Some notable outstanding challenges

Transparency:

- RTS does not include provisions for package transactions for pre-trade transparency – ESMA does agree that appropriate provisions are needed and recommends an amendment to the level 1 text
- LIS and SSTI thresholds are set at a lower level than post-trade thresholds
- The majority of equity derivatives are deemed liquid

Non-discriminatory access to trading venues, CCPs and benchmarks:

- The numerous concerns that we raised in our response, in particular the unworkable nature of the "economic equivalence" assessment, remain.
- ESMA has now given the National Competent Authority significantly more power and discretion to decline an access request.
- Benchmarks now have their own, separate, RTS

Commodities – ancillary activities

On the positive side:

- The thresholds have been significantly increased and have been varied by commodity asset class.
- A “trading activity test”, which has contains a variety of thresholds, has replaced the “capital employed” test that was previously proposed by ESMA.
- Certain trades do not count towards the test:
  - intra-group trades;
  - commercial hedges and treasury financing activities; and
  - certain transactions entered into to fulfil liquidity obligations on trading venues.

Commodities – ancillary activities

However, there are a number of challenges with the new tests:

- A firm that loses the exemption will need to apply to be authorised as an investment firm, which will take months. ESMA acknowledges that firms will want to trade during the period between application and authorisation, but has no power to grant an exemption – accordingly, firms risk committing a criminal offence if they continue to trade between the period they lost the exemption and received (several months later) their authorisation as an investment firm.
- There are material drafting errors in the RTS (the numerator of the market share test should refer to the gross notional of trades in the relevant commodity asset class "that was entered into in Europe", but these last few words were erroneous omitted
- The denominator of the trading activity test means that trading in the relevant commodity asset class is only measured against trading in MiFID II financial instruments – it does not consider non-trading business
- You can only rely on the intra-group exemption if your third-party counterparty is in a jurisdiction considered equivalent under EMIR
- In spite of the majority of respondents saying that ESMA's EMIR Q&A response (question 10) on hedging should not be adopted as firms look at whether a portfolio of positions is risk reducing in aggregate and it is hard to segregate what is hedging versus what is risk reducing, ESMA propose to insert the EMIR Q&A response into MiFID II
- "Gross notional value" is not defined and must be calculated in EUR

Commodities – position limits

On the plus side, for cash and physically settled commodity contracts, ESMA listened to our feedback and agreed that the spot month limits should be determined by reference to deliverable supply, whereas the other months' limits should be determined by reference to open interest.

However:

- ESMA has proposed new, lower, position limit thresholds (25%, subject to adjustment down to a floor of 5% or up to a cap of 35%, instead of the previously proposed 25% plus or minus 20%) and has introduced a new regime for new/illiquid contracts.
- Netting for the purposes of position limits has been determined extremely narrowly: economically equivalent OTC derivative contracts must have an identical contractual spec to the contracts traded on a trading venue.
- Firms cannot net against their physical commodity holdings nor against their non-MiFID instruments.
- Non-Financial Entities (= Non-Financial Counterparties under EMIR) can apply for an exemption to the position limits, but must do so on a per-contract basis and wait up to 21 days for their National Competent Authority to approve the exemption: that is unworkable.

European Commission's Call for Evidence

On 30 September 2015, the European Commission launched its "call for evidence", under which the European Commission has asked to receive data to back up any assertions that there are inconsistencies, overlaps and gaps in existing and in-train regulation, or unintended consequences

The consultation period closes on 6 January 2015

In the same vein, the European Parliament also published a draft report in September entitled the "ECON own-initiative report on stocktaking and challenges of the EU Financial Services Regulation"

FIA Europe presciently published a paper in June on just this topic, entitled "A Review of the Cumulative Effect of EU Derivatives Law Reform", which we shared with the European Commission and certain MEPs earlier in the summer

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Cross-border issues

Equivalence/recognition provisions contained in most dossiers:

Article 13 EMIR: Importance for intra-group trades

Article 25 EMIR: US CCP recognition: impact under CRDIV regarding QCCP status

EU Benchmarks: Audit of third country benchmarks against IOSCO principles

MiFIR: Potential need for non-EU users of Direct Electronic Access to obtain authorisation as an investment firm and to establish an EU branch

CCP risk

- FIA Global CCP Risk Review paper
- EMIR Review
- FIA Europe letter to UK CCPs on non-default loss allocation
- Bank of England Open Forum paper: Building Real Markets for the Good of the People
- Awaiting publication of European Commission proposals on CCP Recovery and Resolution, expected second week of Jan 2016: query how it will interact with the Bank Recovery and Resolution Directive, for those CCPs that are authorised as credit institutions
- ISDA paper on CCP stress testing

Benchmarks

Multiple consultations and regulations:

- **EU regulation on benchmarks**: Approach to third countries and critical benchmarks is being actively discussed. Regulation is currently anticipated to go-live in Q2/Q3 2017

- **Fair and Effective Markets Review (FEMR)**: 7 new benchmarks (Ice Brent, Gold and Silver) were brought in scope for LIBOR-type regime this year

- **MiFIR:** Provides for non-discriminatory access to benchmarks. Goes live on 3 January 2017

- **FCA consultation on proposals for fair, reasonable and non-discriminatory (FRAND) access to regulated benchmarks**: further UK legislation likely

Conduct / Market Abuse

- Fair and Effective Markets Review (FEMR): 21 recommendations aimed at restoring trust in the financial services industry.

- Market Abuse Regulation: The final draft RTS have just been published by ESMA. Go-live is January 2017

- REMIT reporting: the aim of the REMIT regulation is to capture market abuse in the wholesale power markets. The regime went live on 7 October 2015 – as with EMIR, there have been significant teething issues, not least with the regulators own IT systems (to which all relevant trade data is reported)

- Bank of England Open Forum paper: Building Real Markets for the Good of the People – there is a public hearing later this month

- Query if conduct regulation will be expanded further to include the larger corporates, in light of the Volkswagen scandal

Securities Financing Transaction Regulation (SFTR)

FIA Europe is interested in SFTR by virtue of its application to commodities markets. It is expected to come into force in April 2016

SFTR aims to provide transparency by requiring the reporting of securities financing transactions (SFT) undertaken in the shadow banking sector. It applied to repurchase agreements, securities lending/borrowing, commodities lending/borrowing, buy/sell back and sell/buy back transactions, as well as "reuse" of collateral

Applies to EU counterparties and third country counterparties if the SFT is concluded in the course of operations of an EU *branch* of that counterparty

May 2018: Reporting obligation for EU and third-country investment firms and credit institutions applies

August 2018: Reporting obligation for EU and third-country CCPs and CSDs applies

November 2018: Reporting obligation for other financial counterparties and third-country entities applies

February 2019: Reporting obligation for non-financial counterparties applies

Obligation to report by the following working day: details of the SFT concluded, as well as any modification or termination. Report to trade repositories. Delegated reporting permitted. Backloading obligations. Financial Counterparties can be responsible for reporting of both parties in some circumstances

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Cyber-security and technological innovation

- We are just getting started in this area and will liaise with Washington/FIA Tech significantly post-merger
- We held a FIA Europe "InfoNet" event on the topic of technological innovation in our industry
- FBI briefing at FIA's Boca Raton conference in March 2015 on cyber-security
- QED conference in Brussels later this month on cybersecurity, which has shot up the public agenda in recent weeks due to the "Talk Talk" website hack
- We are monitoring developments relating to adoption of blockchain technology by CCPs and others

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Capital Markets Union

- This is the European Commission's flagship project: aim is to deliver "jobs and growth" in Europe

- It mostly relates to cross-border (intra-EU) investment in cash equities and in reviving a more simplified cross-border securitisation market

- It will also consider harmonisation of conflicting EU member state insolvency law regimes (potentially including with respect to indirect clearing under EMIR and MiFIR), but this is a political hot potato. Many member states consider that Brussels has now power to override member state insolvency laws.

- All new regulations are being considered through the "jobs and growth" lens – if the regulation will not lead to jobs and growth, it is kicked into the long grass

- We worked closely with ISDA on the European Commission's CMU consultation