



Patrick Pearson
European Commission
Head of Unit - Financial Markets Infrastructure
Rue de Spa 2
1000 Brussels

Belgium

By email: patrick.pearson@ec.europa.eu

18 July 2017

European Commission EMIR Review Proposal – Part 1 (REFIT Proposals)

Final Response

FIA¹ (“FIA”) welcomes the European Commission’s proposals and sets out below its comments on the European Market Infrastructure Regulation (EMIR) Review proposal Part 1 of the REFIT proposals. Many of the Commission’s proposed measures reflect FIA’s previous input in the Commission’s consultations on the EMIR review and the “Call for Evidence”. We remain available to discuss the response in more detail.

Executive Summary

- **Reporting of exchange traded derivatives (ETDs).** FIA encourages the Commission to clarify:
 - will the clearing member-to-client trade still be reportable?
 - if it is still reportable, does the CCP have to report both the CCP-to-clearing member trade and the clearing member-to-client trade?
 - what, if any, are the ongoing obligations of the clearing member and/or client to check the accuracy of the data that has been reported on their behalf by the CCP?
 - do the reporting requirements apply to trades cleared through a third-country CCP?
- **Proposed amendments to Article 39 (bankruptcy remoteness provision).** FIA recommends that:
 - the proposal be extended to address indirect clearing arrangements: direct clients providing indirect clearing services should also be required to hold client collateral on a bankruptcy remote

¹ FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in London, Singapore and Washington, D.C. FIA’s membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry.

www.fia.org

- basis and the proposals should clarify how clearing members (CMs) should treat the assets and positions of their clients in the event of a client default (when their direct clients are providing clearing services to indirect clients);
- the proposal should not cover the situation of a CCP default. CCP resilience, recovery and resolution should be solely addressed in a separate EU regulation²;
 - EU authorities obtain one or more independent, reasoned, external legal opinions confirming the legal effectiveness of the proposed drafting under EU and national insolvency laws - further consideration should also be given to existing national EU member state insolvency frameworks (e.g. UK's Part VII of the Companies Act 1989, Articles L.440-7 to L.440-9 of the French *code monétaire et financier*, or Article 102b of the German Introductory Act to the Insolvency Statute). FIA is concerned that, as drafted, the current proposals are not legally effective.
- **Proposed amendments to Article 4 (FRAND).**
 - In principle, FIA agrees with the objective of CMs offering clearing services on fair, reasonable and non-discriminatory terms (FRAND).
 - However, FRAND requirements will not of themselves promote better access to clearing –rather it is *economic, commercial and risk* considerations that restrict a potential client's access to clearing.
 - Further clarity is required:
 - on the interaction between FRAND under EMIR and other conflicting EU regulation such as MiFID II (that requires clearing services to be provided on “reasonable commercial terms” and for clearing members to “publish the conditions under which it offers clearing services”, etc.);
 - on the meaning of FRAND requirements, especially the words “non-discriminatory”;
 - on the geographical (EU only?) and product scope (OTC derivatives clearing, but not exchange-traded derivatives) of the FRAND requirements;
 - FRAND requirements should:
 - not result in a mandatory obligation on clearing brokers to offer a clearing service to all potential clients or on mandatory terms but should enable them to offer a clearing service in a competitive, commercial and prudent risk-mitigating manner; and
 - be set out at Level 1.
 - **Suspension of the clearing obligation.** An effective, timely and transparent process is required and the consequences of suspension should be spelt out.
 - **Removal of frontloading and backloading requirements.** FIA supports the removal of these requirements.
 - **CCP transparency.** FIA welcomes the Commission's proposal in relation to the CCP transparency requirements on their initial margin models and suggests a number of further enhancements – our response is aligned with ISDA's on this topic and encourages further alignment with the new CPMI/IOSCO guidelines. CCPs should be mandatorily required to publish self-assessments against CPMI/IOSCO's Principles for Financial Market Infrastructures (the PFMI).
 - **CCP investment criteria.** FIA recommends that the Commission add a new section 1a to Annex II of Commission Delegated Regulation (EU) No 153/2013 to permit CCPs to invest in certain money market funds, to align with equivalent US rules.
 - **Non-Financial Counterparties.**
 - FIA supports the proposal to retain a hedging exemption for NFCs.
 - FIA supports the proposal that NFCs only have to clear the specific class(es) of OTC derivatives in respect of which they have exceeded the clearing threshold.

² In November 2016, the Commission published a proposal for a regulation on CCP resilience, recovery and resolution which deals with CCP default, so any legal consequences in the event of the CCP default should be dealt with in that Regulation.

- Corresponding tweaks are required to the collateral requirements for uncleared OTC derivatives, so that a NFC+ is only required to exchange collateral with respect to OTC derivatives in the same asset class(es) whose clearing threshold(s) that NFC+ has exceeded.
- **Financial Counterparties.** FIA supports the positions of both ISDA and AIMA.
- **Portfolio Compression.** FIA supports the position of ISDA.

Our more detailed response on each of these points is set out below.

1. Reporting of ETDs

In principle, FIA welcomes the Commission’s proposal to adopt a single-sided reporting model for the reporting of ETDs. FIA recognises that Central Counterparties (CCPs) hold the “golden source” of the transaction because they are key to reporting the systemic risk implications for ETDs. With CCPs being responsible for reporting the required information, regulatory authorities will continue to be able to monitor the systemic risk of EU CCPs and CMs, for which transparency is the primary function and purpose of the EMIR reporting obligation. FIA does, however, think that the proposal in relation to the reporting of ETDs would benefit from clarification on the following key issues:

- (a) **Will the client – CM trade still be reportable?** The client - CM trade should not be reportable, in keeping with the Commission’s intention to simplify the reporting regime. Regulators will still continue to receive detailed information about ETDs, given that there will be an enhanced reporting regime in place once MiFID II starts in January 2018.
- (b) **If the client – CM trade will still be reportable, is it the intention that the CCP will report both the CM – CCP trade and the client – CM trade?** If so, this could create problems as it would require client information to be passed up the chain via the CM to the CCP to enable it to report the client leg. This would be cumbersome and undermine the goal of the proposal to streamline the reporting requirements and reduce the burden on counterparties.
- (c) **What (if any) are the ongoing obligations of the CM and/or client to check the accuracy of the data that has been reported on their behalf by the CCP?** The non-reporting party should have no ongoing obligations to check the data that has been reported by the CCP on their behalf, given that the CCP is the “golden source” of the information. In addition, if there were ongoing obligations to check the data, it would mean that non-reporting parties would need to establish additional connections to the trade repositories (TRs) used by the various CCPs that they clear through in order to obtain details of the data that has been submitted on their behalf. This would be onerous from both an operational and cost perspective. Non-reporting parties would have to establish connections to the TRs that the CCPs use, (which may be different to the TRs such non-reporting parties use for their EMIR reporting obligation of OTC derivatives) and pay the associated TR fees. This in turn may mean that the proposal would complicate, rather than streamline, the current ETD reporting requirements.
- (d) **Would this proposal still apply when the trade is cleared through a third country CCP?** Third country CCPs are not subject to EMIR reporting requirements and as such this data would not be reported to a trade repository under EMIR.

2. Increasing access to central clearing – Proposed amendments to Article 39 (bankruptcy remoteness provision)

Regulatory intent

FIA welcomes the Commission's proposal to address concerns that the industry³ and regulators⁴ have previously expressed in relation to legal effectiveness of the default management process as envisaged under EMIR in Article 48. There has been a prevailing view among legal experts in Europe that the existing EMIR language around CCPs' management of CMs' default does not achieve supremacy over and does not override national insolvency laws as regards porting, direct return of liquidation proceeds to clients ('leapfrog payment') and return of liquidation proceeds to the defaulted CM for the account of its clients. However, FIA is concerned about the scope of the proposal and the legal effectiveness of the proposal, as set out further below.

Scope of the proposal

The proposal should be extended to clients of clearing members that offer clearing services

The proposal seems to be limited to CCPs and CMs but it does not extend to cover indirect clearing. FIA encourages the Commission to extend the proposal so as to require direct clients providing indirect clearing services to hold client collateral on a bankruptcy remote basis and to clarify the required treatment by CMs of the assets and positions of their clients in the event of their client's default (when that client provides clearing services to its clients) so that CMs can meet their requirements under the draft indirect clearing RTS under EMIR and MiFIR.

The proposal should not cover the situation of a CCP's default

The proposal provides for bankruptcy remoteness of assets and positions held by the CCP in the event of the CCP's default. The rationale for this extension of scope is unclear and is not explained in the proposal or mentioned in the Impact Assessment. It does not fit within the scope of EMIR and would be more appropriately dealt with in Commission's proposed regulation relating to CCP resilience, recovery and resolution.

Further, it does not reflect how CCPs are structured and operate today. Making assets bankruptcy remote from the CCP creates material challenges. Under the CCP RTS (153/2013), Article 45(2), a CCP must invest 95% of cash assets that it receives in non-cash assets. This is done typically through reverse repurchase agreements. A new EMIR requirement for these assets to be bankruptcy remote from the CCP would effectively mean that repo counterparties would no longer be able to deal with CCPs, because some other, less creditworthy and potentially unknown entity would represent the credit risk on such transactions. Without a lot more legislative intervention than that proposed or an enormous amount of legal restructuring, there would be no mutuality of obligations between repo obligations and the related collateral

³ By way of background, as has been noted in several responses related to the EMIR review, such as by FIA, the conflict of national insolvency laws with the porting and segregation provisions of EMIR is a major cause of uncertainty and results in risks that porting may not be offered in practice in a number of clearing member jurisdictions. Were a local court to find porting to have been in breach of its insolvency laws, a litigant could potentially enforce that judgement anywhere in the EU under recognition of judgments directives. CCPs cannot run the risk of enforcement of attachment judgments relating to the collateral they hold in such a situation.

See FIA's Response to the EMIR Review:

https://fia.org/sites/default/files/content_attachments/FINAL%20FIA%20Europe%20response%20to%20the%20EMIR%20Review.pdf

⁴ See ESMA's EMIR Review Report No. 3 on segregation and portability:

https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1253_-_emir_review_report_no.3_on_segregation_and_portability.pdf

as a result of EMIR II. This provision would therefore concentrate cash deposit risk at CCPs and force CCPs out of compliance with EMIR, as CCPs would no longer be able to engage in repurchase transactions.

Legal effectiveness of the proposal

FIA remains concerned that the proposed drafting in the new paragraph 11 of EMIR Article 39 is not legally effective, and believe that any action taken by the CCP in the event of the CM's default would still be highly susceptible to legal challenge by insolvency practitioners in EU member states where the CMs are located, arguing that it does not override national insolvency regime.

Insolvency remoteness does not depend on the three segregation criteria in EMIR Article 39(9). Instead, insolvency remoteness of margin transfers depends on mechanisms such as:

- the means of taking margin by way of security i.e. whether by way of title transfer (= margin-giver is unsecured creditor in insolvent estate of margin-taker) or security interest (= secured creditor, subject to relevant insolvency law hierarchy in margin-taker's jurisdiction), or
- using a trust mechanism over the collateral (where this works under local law – e.g. UK client money regime (CASS)), or
- using a fully formed statutory insolvency law override like Part VII Companies Act 1989 which explicitly provides for a CCP's default management procedure to trump what a CM's insolvency practitioner can do.

If a security mechanism is used to ensure insolvency remoteness, it will likely involve a charge/assignment by way of security/pledge, the governing law of which depends on the *lex situs* of the margin assets. As a consequence, this means that there would be a potential interface with the EU's new securities law reform roadmap proposal if the aim of the latter is, for example, to fix the *lex situs* of book entry securities. Ensuring the security interest is watertight also depends on other factors driven by the governing law of security documentation and the *lex situs* of the assets. There are overlaps here with book entry securities and other provisions of the Financial Collateral Directive which, as transposed into national law, governs title transfer collateral arrangements and security financial collateral arrangements regarding their governing law and perfection requirements and protects against some of the vulnerabilities to attack by insolvency practitioners. There is also an interface with the provisions of the Settlement Finality Directive which fixes the governing law of rights of holders of securities used as collateral to clearing members as the law of the member states in which the right to the securities is legally recorded on a register/account/deposit system in a member state.

In short, the framework for the legal effectiveness of the insolvency remoteness of the assets and positions of clients or indirect clients is complex and will differ, amongst other things, depending on the arrangements between the parties, the jurisdiction of the parties, the type of asset and the *lex situs* of the assets. The level of this complexity should not be underestimated and FIA believes that there is a lot of further thought and work that remains to be done in this context, including consideration of whether EMIR is the appropriate, or only piece of, legislation to address these matters.

If the intent of the new paragraph 11 of EMIR Article 39 was to create a pan-European statutory insolvency override, then FIA suggests that consideration be given to existing statutory frameworks in certain member states, such as the UK's Part VII of the Companies Act 1989, Articles L.440-7 to L.440-9 of the French *code monétaire et financier*, or Article 102b of the German Introductory Act to the Insolvency Statute. An equivalent regime that would work in all EU member states is something that FIA would support and FIA would be willing to assist the Commission in designing such pan-European insolvency law override.

If it has not already done so, FIA recommends that the Commission seek external, independent and reasoned legal opinions to confirm whether the proposed drafting achieves a desired outcome and is legally effective in, at least, all EU member states. FIA encourages the Commission to share such opinions with interested stakeholders (including industry) and only proceed with changes if sufficient opinions are positive.

Separately, FIA notes that the proposed drafting in the new paragraph 11 of EMIR Article 39 creates a perception that Article 39(9) is optional for CCPs to meet, which is not the case. It also raises questions regarding the legal status of assets and positions held at the CCP where the Article 39(9) requirements are not met.

3. Increasing access to central clearing – Proposed amendments to Article 4 (FRAND requirements)

General

FIA would welcome the opportunity to discuss the FRAND requirements in the context of clearing services in more detail.

FIA notes that the rationale for introducing FRAND into EMIR appears to be to tackle hurdles with access to clearing⁵. FIA does not believe that the issue with clients accessing clearing services is linked to the fair, reasonable and non-discriminatory basis on which such clearing services are offered. Indeed, CMs would consider that they offer clearing services on that basis now and are required, or shortly will be required by regulation, to offer clearing services on a certain basis in any event (see Interaction between FRAND and other existing provisions below).

Instead, and as FIA has previously pointed out⁶, the issue with clients accessing clearing services is driven by *inter alia* whether it makes economic sense for CMs to offer such services when set against the regulatory capital and leverage ratio constraints that CMs operate under, the low interest rate environment, the credit quality of the potential client and its access to liquidity in order to meet its margining obligations, etc.

FIA is, therefore, concerned that FRAND, and in particular the “non-discriminatory” element, implies that in certain circumstances CMs would be obliged to mandatorily provide clearing services to clients without the ability to choose not to act as their CM on both risk and/or commercial grounds.

FIA notes that the Commission is empowered to adopt a delegated act specifying the conditions that would qualify as FRAND. If FRAND is introduced, given its potential ramifications, it would be more appropriate for the Level 1 text to set out the high level considerations for determining what constitutes FRAND rather than leaving this to be wholly determined at Level 2.

FIA would be pleased to offer its assistance to contribute to and comment on the drafting of the relevant texts early on in the process.

In addition, FIA have the following observations:

The meaning of FRAND

⁵ European Commission’s proposal to amend EMIR of 4 May 2017, page 10, final bullet point.

⁶ FIA Analysis: Leverage ratio proposals will negatively impact client clearing: <https://fia.org/articles/fia-analysis-leverage-ratio-proposals-will-negatively-impact-client-clearing>

FIA acknowledges that the FRAND requirements have been introduced and apply in various contexts, typically when it comes to the provision of essential services or where there is a monopoly. Clearing services do not fall under either of the categories.

The FRAND requirements have fairly recently also found their way into the area of financial services regulation (e.g. Benchmarks Regulation and MiFID II), however there is a material difference between the provision of clearing services and other services to which the FRAND requirements already apply, due to which a careful consideration needs to be given when specifying and calibrating the FRAND requirements.

Unlike essential services and other areas in which service providers are subject to the FRAND requirements, clearing firms, when providing clearing services to their clients, assume counterparty credit risk, which they are required to actively manage and mitigate. A data provider, a patent provider, a benchmark provider, etc. (all subject to FRAND) do not assume counterparty credit risk. In the event of a conflict between FRAND and other requirements that CMs are subject to, it would be unacceptable if the FRAND requirements were to supersede all other (e.g. prudential and risk) requirements, as that would likely result in even fewer CMs that are willing to provide client clearing services. This would go against the Commission's very core policy objective to promote and increase access to central clearing for end users.

FIA believes that the meaning of FRAND should take into account the need for firms to be able to continue to decide which clients they onboard. Firms currently make decisions about which clients to onboard based on two key factors: risk and commercial considerations. Both factors are critical to enable a firm to prudently manage the risk that is associated with providing clearing services and to be able to continue to offer clearing services in a sustainable, commercially viable way.

In terms of risk, firms should not be expected or obliged to offer clearing services to any potential clients that do not satisfy Anti-Money Laundering (AML) and Know-Your-Customer (KYC) checks. In addition, firms should not be required to onboard clients where they cannot adequately manage the risks associated with offering clearing services to that client. If firms are forced to onboard unsuitable clients, this would actually increase, rather than mitigate risk per EMIR's objectives.

There are also commercial considerations which must be taken into account when determining the pricing at which clearing services are provided to clients. Firms need to be able to continue to exercise judgment about the prices that are set for clearing services, by taking into account factors such as the client's anticipated trade volumes. In practice, a minimum level of trading activity will typically be required (otherwise a 'minimum account activity fee' may need to be levied) in order to make it commercially viable for a firm to offer clearing services to a particular client. The primary driver for this is that there are large fixed costs of operating a clearing business and due to regulatory compliance obligations. It is important that firms are able to set appropriate pricing structures to sustain the operation of a clearing business. There has already been a decline in the number of clearing firms in the market in recent years and this downward trend is likely to be exacerbated if firms are constrained from operating in a commercially sustainable way.

When it comes to the contractual framework in the context of derivatives clearing, clearing agreements are negotiated depending on the protections requested by the client and the volume and class of products to be cleared, across all issues from pricing to margin to segregation models. For example, standard FIA and ISDA clearing documentation contain tens of different elections and optional clauses, depending on the proposed structure and client / clearing member preferences. Any application of FRAND to this sector will need to be sufficiently flexible to recognize the complexity of needs of different clients from their clearing members and the need for documentation to be tailored.

Interaction between FRAND and other existing provisions

It is currently unclear how the FRAND principle under EMIR is intended to interact with other similar provisions that exist under EMIR and MiFID II.

Under EMIR Article 39(7), CMs are currently required to offer clearing services on reasonable commercial terms.⁷ Under MiFID II, CMs, that are investment firms, will be required under Article 27(1) of Commission Delegated Regulation (EU) 2017/589 (MiFID II RTS 6) to “publish the conditions under which it offers clearing services” and “shall offer those services on reasonable commercial terms”.

In relation to indirect clearing arrangements, CMs that facilitate indirect clearing are required to do so on “reasonable commercial terms” (see Article 27(1) Commission Delegated Regulation (EU) No 149/2013 regarding indirect clearing of OTC derivatives⁸ and Article 4(1) of the draft MiFIR RTS regarding indirect clearing arrangements for ETDs).⁹

In addition, Article 25 of MiFID II RTS 6 contains a number of due diligence criteria¹⁰ that CMs have to apply when assessing whether they can provide clearing services to a client. They must also set out in a written agreement between the CM and its clients the consequences if the criteria have been breached. It is unclear how the FRAND requirements are going to interact with the MiFID II RTS 6 obligations on CMs which envisage a degree of flexibility and subjectivity as regards on-boarding new clients and providing clearing service to existing clients. FIA believes that clearing firms should keep the flexibility of setting or changing their own assessment criteria based on risk and other factors, and that they should apply them in a consistent, non-discriminatory and equitable way.

It also remains unclear as to how the FRAND requirements differ from the existing standard to offer clearing services on “reasonable commercial terms”. FIA would ideally not want a separate requirement under EMIR in addition to the existing aforementioned EMIR and MiFID II requirements. This is especially the case as the new EMIR obligations will come into force potentially over a year after the MiFID II obligations will already apply, and the obligations under EMIR and MiFID II should ideally be as aligned as possible.

FIA would welcome clarity of the FRAND requirements in terms of interactions with other existing provisions.

Scope of FRAND requirements

⁷ CCPs and clearing members shall publicly disclose the levels of protection and the costs associated with the different levels of segregation that they provide and ***shall offer those services on reasonable commercial terms***. Details of the different levels of segregation shall include a description of the main legal implications of the respective levels of segregation offered including information on the insolvency law applicable in the relevant jurisdictions.

⁸ Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP. Article 27(1) states: ***A clearing member that offers to facilitate indirect clearing services shall do so on reasonable commercial terms.*** Without prejudice to the confidentiality of contractual arrangements with individual clients, the clearing member shall publicly disclose the general terms on which it is prepared to facilitate indirect clearing services. These terms may include minimum operational requirements for clients that provide indirect clearing services.

⁹ ESMA draft regulatory technical standards on indirect clearing arrangements under EMIR and MiFIR (ESMA/2016/725): ***A clearing member that offers to facilitate indirect clearing services shall do so on reasonable commercial terms.*** Without prejudice to the confidentiality of contractual arrangements with individual clients, the clearing member shall publicly disclose the general terms on which it is prepared to facilitate indirect clearing services. These terms shall include minimum financial resources and operational capacity requirements for clients that provide indirect clearing services.

¹⁰ For example, one of the requirements is for clearing members to assess their clients by their credit strength.

We understand that the FRAND requirements would apply to clearing members as defined under EMIR, which means that their scope is not limited to EU CMs only. What remains uncertain is whether the proposal covers CMs (and their clients when they offer clearing services) clearing on all CCPs globally, or whether it is limited to the provision of clearing services on EU CCPs.

In addition, the proposal for FRAND is based on perceived issues relating to the lack of access to clearing services, lack of competition and lack of transparency around cost of providing clearing services – all with respect to OTC derivatives only. There is no reference to ETDs in the context of FRAND and the Impact Assessment explicitly only analyses potential issues with access to central clearing that some firms have been experiencing with respect to OTC derivatives, and provides data and arguments only with respect to OTC derivatives.

The same issues do not seem to exist or be a problem in the area of ETDs, as central clearing of ETDs is not a novelty and has been an integral part of ETD markets since their inception. FIA therefore believes that the existing framework for the provision of clearing services for ETDs, whereby CMs (and their clients) need to provide clearing services on reasonable commercial terms, works well and is sufficient, so in the absence of a regulatory/policy rationale, there does not seem to be a need for imposing additional requirements on CMs when providing clearing services for ETDs over and above the existing ones that they are already subject to (or will become subject to when MiFID II applies).

FIA would welcome clarification of the FRAND requirements in terms of scope.

4. Changes to the clearing obligation - suspension of the clearing obligation

FIA supports the introduction of a mechanism and new powers for the Commission on specific grounds, to temporarily suspend the clearing obligation on request by ESMA.

As recommended by FIA in its response to the Commission's EMIR review consultation paper, regulators should have the power to suspend or terminate the clearing obligation for any OTC derivative contract if the relevant market situations so require.

The consequences of any such suspension should be clearly set out in EMIR. Whilst the issue of implementing an effective, timely and transparent process for suspending/terminating the clearing obligation is essential, it is also vitally important to clarify the consequences of such suspension/termination on those impacted contracts which are already being cleared and the ability for participants to continue to trade such contracts, notwithstanding the change to the clearing obligation.

5. Removal of frontloading and backloading requirements

Frontloading

FIA supports the removal of the frontloading obligation, as market participants are unable to accurately price trades that will be cleared at a future date (as it would likely lead to a divergence in pricing and overall market disruption). It is crucial to ensure that the clearing obligation only applies to OTC derivative contracts where those contracts are suitable for clearing, and that the mandates be implemented so as to minimise market disruption, ensure the continuity of markets participants' hedging programmes and foster an environment where derivatives users are encouraged to reduce bilateral risk – the removal of the frontloading requirement helps to support all of this.

Backloading

FIA welcomes the Commission's proposal to remove the reporting backloading obligation for OTC derivatives and ETDs. This would appear to be a sensible approach given that the primary purpose of the EMIR reporting regime is to improve transparency and enable regulatory authorities to monitor systemic risk. The backloading of historic data adds little or no value in this regard.

6. CCP Transparency

FIA's response is aligned with that of the International Swaps and Derivatives Association ("ISDA") on this topic.

Under the proposal, CCPs are required to provide their CMs with:

- (a) a tool to simulate the initial margin requirements on the clearing of a new transaction; and
- (b) the initial margin model it uses.

In the past, FIA stressed the importance of increased transparency of initial margin models being made available to all CCP members and the Commission's proposal is welcome. In line with ISDA's response, FIA makes the following observations:

Margin simulation tool

Many CCPs already offer margin simulation tools to their members. We welcome making this a requirement for all EU CCPs.

Such a simulation tool should be able to produce several measures:

- The initial margin for a given portfolio;
- The additional initial margin required to clear additional trades; and
- The initial margin required to clear a given trade on a standalone basis.

It would be useful, albeit not essential for the simulation also to provide incremental default fund contributions for the above cases, which would then be used to estimate additional default fund contributions for new client portfolios on changes in the house portfolio.

We would welcome more clarity on what is meant by "on a gross basis": Most CCPs calculate initial margin as one net figure across a whole portfolio, taking portfolio benefits into account if applicable. Simulation of new trades will only yield meaningful results if the net initial margin across the whole portfolio (including the added transaction) is part of the result (as in the second bullet point above).

We appreciate that the result of the simulation cannot be binding, as the margin models might react to new market data, or the CCP will make use of their right to ask for additional margin. The result of the simulation tool should however show the margin as the CCP models calculate it at the time with all relevant add-ons.

CCP initial margin model transparency

The current discussion around CCP recovery and resolution highlights the importance of CCP resilience. Notably, sufficient margin requirements are key components of CCP resilience.

All clearing participants, not only members, will welcome increased transparency of CCPs' models.

Understanding margin models and being able to scrutinize them will help participants to gain comfort with the risk management models of a CCP, and increase their confidence that the default of a CM can be managed using initial margin without recourse to mutualised resources in the waterfall under most market conditions.

The usefulness of this disclosure will depend on the level of detail and comprehensiveness of the information provided. Documentation of the margin model should also include all add-ons for risks not covered by the core margin model, for instance concentration, liquidity, seasonality, procyclicality, basis or idiosyncratic risks. Overall, the documentation should allow members to fully replicate base margin and all add-ons. Additionally, the documentation should also capture rationale for assumptions made/parameters used – particularly Margin Period of Risks (MPOR) – in the margin framework.

FIA suggests that the Commission should closely align the requirements in EMIR with the expected guidance from CPMI/IOSCO (following their consultation paper “Resilience and recovery of central counterparties (CCPs): Further guidance on the PFMI”). The consultative report contains an extensive list of information to be disclosed and a feedback mechanism to be employed for model changes. FIA proposes aligning EMIR with the new IOSCO guidance and adding a feedback mechanism as proposed by CPMI/IOSCO to the disclosure requirement. FIA also asks the Commission to specify the required level of detail along the PFMI/IOSCO guidelines, either in level 1 or level 2 of EMIR.

Given the importance of stress testing for the sizing of default funds and therefore the overall financial safeguard package of a CCP, FIA also asks to include – again in line with the CPMI/IOSCO guidance – stress testing frameworks in the disclosure and feedback requirements.

Other transparency requirements

While nearly all EU CCPs provide quantitative disclosure according to IOSCO standards, not all EU CCPs produce a self-assessment against the Principles of Financial Markets Infrastructures (PFMI). Such self-assessments are important tools for clearing participants to understand the whole risk management framework of a CCP and the risk they are taking by using a particular CCP.

FIA suggests that EMIR should require CCPs to produce such self-assessments for their clearing participants.

Further, FIA expects that CCPs are currently performing backtesting using a variety of schemes, including member portfolio back tests and static portfolio backtesting, to ensure adequacy of financial resources including IM. Where CCPs are performing backtesting, FIA recommends that the CCP should be required to provide members with information on backtesting, specifically member portfolio level back tests, hypothetical portfolio level back tests, factor level back tests and product level back tests. Where CCPs are not currently performing such backtesting, FIA would recommend introducing a requirement to oblige CCPs to perform different types of backtesting.

Additional guidance to PFMIs by CPMI-IOSCO

As mentioned above, CPMI/IOSCO have issued a final report on “Resilience and recovery of central counterparties (CCPs): Further guidance on the PFMI”.

FIA strongly recommends that the Commission should use the EMIR review as an opportunity to integrate the additional guidance as applicable either in Level 1 or Level 2 of EMIR.

7. CCP investment criteria

FIA recommends to the Commission that CCPs be permitted to invest in money market funds meeting certain strict criteria, to align with the equivalent US rules (17 CFR 1.25).

This can be achieved by adding a new section 1a to Annex II of Commission Delegated Regulation (EU) No 153/2013, specifying the required characteristics, directly and/or by reference to the permitted type of money market fund defined in the Money Market Fund Regulation (Regulation (EU) 2017/1131), such as a public debt constant net asset value MMF [with a AAA credit rating].

This change would: (i) allow CCPs to exchange cash for non-cash collateral, which is easier to segregate and is more secure; (ii) remove an existing disadvantage suffered by EU CCPs, thereby levelling the playing field internationally; and (iii) promote the EU’s UCITs and/or money market fund product.

8. Non-financial counterparties

EMIR exempts Non-Financial Counterparties (NFCs) from clearing and margining requirements if they do not breach any of the clearing thresholds with respect to their non-hedging OTC derivatives. OTC derivatives entered into for the mitigation of commercial risks stemming from the operative businesses (e.g. to hedge against currency, interest rates or commodity price fluctuations) are not counted against the relevant clearing threshold. FIA expresses its full support to the retention of this so-called “hedging exemption” in Article 10(3) EMIR, because this hedging exemption enables NFCs to continue to perform effective risk management.

In addition, FIA supports the change proposed in Article 10(1)(b) of the proposal to restrict the clearing obligation to the specific classes of OTC derivatives for which the clearing threshold has been exceeded. This amendment will result in a proportionate and appropriate response to the breach of the clearing threshold for one asset class.

However, the Commission’s proposal has omitted to introduce a complementary amendment to Article 11(3) of EMIR as regards to margin requirements for uncleared transactions. This means that an NFC that exceeds the clearing threshold in only one asset class will continue to be treated as an NFC+ for the purposes of the uncleared margin rules and be required to exchange collateral in relation to all OTC derivatives, irrespective of the asset class to which they belong and whether they exceed the clearing threshold for each such asset class. By only making amendments to Article 10(1)(b) and not Article 11(3), the proposal does not provide any practical relief to NFCs as clearing relief without corresponding margin relief still puts a substantial burden on NFCs. Such a result seems incongruous with the proposed relief from an all-encompassing clearing obligation introduced in Article 10(1)(b) and does not alleviate the negative impact the margin rules have on corporate treasury derivative use (e.g. in FX and interest rate derivatives). This derivative activity which is purely for hedging purposes cannot be considered as incurring risks or be even material in terms of value in these asset classes.

The amendment that is proposed for the clearing obligation should also be applied to the uncleared margin requirements so that the obligations are consistent and risk sensitive and proportionate.

9. Financial Counterparties

FIA refers to the responses of the Alternative Investment Management Association (AIMA) and ISDA on this subject, both of which FIA fully supports.

10. Portfolio Compression

FIA refers to the ISDA response on this subject, which FIA fully supports.

We look forward to continued engagement on these important issues.

Sincerely,

A handwritten signature in black ink, appearing to read 'S. Puleston Jones', with a long horizontal flourish underneath.

Simon Puleston Jones
Head of Europe, FIA