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Remarks on EMIR technical standards

Response to the ESMA discussion paper on technical standards for the Regulation on OTC derivatives, CCPs and Trade Repositories of 16 February 2012

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Thank you for the opportunity to comment on the discussion paper "Draft technical standards on the Regulation on OTC Derivatives, CCPs and Trade Repositories". We hope that our contribution is helpful in further detailing the technical standards on the various issues addressed in the paper and are of course more than prepared to provide further detail and explanation on particular items when helpful.

As we represent the interests of our members as users/clients of infrastructure service providers in the field of securities, we have restricted our comments to those parts of the paper that are most relevant in this context and where we think a remark might be helpful.

Remarks on individual questions

I. Derivatives

Clearing Obligation (Article 3)

Q1: In your views, how should ESMA specify contracts that are considered to have a direct, substantial and foreseeable effect within the EU?

We would hesitate imposing a (clearing) obligation extraterritorially on third country parties; a modest and careful approach seems necessary, where the European community has expressed their concerns with regard to (potential) extra-territoriality of other legal regimes. Double and conflicting regulation and supervision should be prevented. A "direct, substantial and foreseeable effect" is a weak basis to establish such an (extraterritorial) obligation as sole ground for clearing obligation. At the other side, we agree with prevention of "evasion of any provision of EMIR" and would like to avoid possibilities for "off-shoring".

We do not yet have suggestions for specifications to this end, but we envisage that some examples may assist in identifying the issue:

1. two Singapore entities engaging in a OTC contract in Euro: does EMIR constitute a clearing obligation, a reporting obligation?
2. two European entities engaging in a OTC contract in USD: does EMIR constitute a clearing obligation, a reporting obligation?
3. a European entity engaged a OTC contract in USD with a US counterpart: does EMIR constitute a clearing obligation, a reporting obligation?
4. a European entity engaged an OTC contract in EUR with a US counterpart: does EMIR constitute a clearing obligation, a reporting obligation?
5. a European entity engaged an OTC contract in AUS $ with an AUS counterpart: des EMIR constitutes a clearing obligation, a reporting obligation?
6. a European bank with a Singaporean branch engaging in a OTC contract: does EMIR constitute a clearing obligation and a reporting obligation?
7. a European bank with a Singaporean subsidiary engaging in a OTC contract: does EMIR constitute a clearing an a reporting obligation?
8. a European bank having a Singaporean counterparty. In this case there is (also) a clearing obligation based on Singaporean Law. Which clearing obligation will prevail?

We think it is important that regulators and supervisors attune their actions globally.

Q3: In your views, what should be the characteristics of these indirect contractual arrangements?

We highly welcome the possibility of indirect clearing arrangements between counterparties/clients and clearing members. We think the wording "a counterparty shall become a clearing member, a client or establish indirect clearing arrangements with a clearing member" is a bit confusing and would like to clarify our view on current practice in this respect .
In this context, only clearing members can have a contractual relationship with a CCP; the client of a (general) clearing member is not a client of the CCP. The essence of the clearing arrangements should be that a counterparty (if not a direct clearing member by himself) is either:

- a direct client of a general clearing member (direct clearing arrangement) or;
- a client of a client of a general clearing member (with an indirect clearing arrangement).

The further provisions in the EMIR regulation and technical standards (should) provide for the right of segregation & portability for counterparties in both situations.
Perhaps unnecessary to say that segregation & portability for retail investors is better served on an " omnibus" level than on an individual level, because of the diseconomies of a small scale.

Risk mitigation for non-CCP cleared contracts (Article 6/8)

Q12: What are your views regarding the timing for the confirmation and the differentiating criteria? Is a transaction that is electronically executed, electronically processed or electronically confirmed generally able to be confirmed more quickly than one that is not?

The timelines for confirmation specified in par. 38 are very tight and would go beyond the purpose of risk mitigation. Position keeping and risk management indeed require fast and unambiguous exchange of key elements of the contract. However, the main elements of the transaction are already determined at the moment of execution of the transaction, and they are legally binding. The confirmation is for administration purposes and - in case of contradiction with elements of the transaction at the moment of the execution - will prevail when accepted by the parties to the transaction.
Complete confirmation is more than an exchange of data; e.g. it includes the signatures of the counterparties. Such would be impossible to produce within these 15/30 minutes timelines.
We propose that complete confirmation (a back office activity) is required by:

- end of business day in cases of electronically executed and processed trades, as indicated in par. 38;
- within five business days for trades not electronically executed and processed as indicated in par. 38 and for trades as indicated in par. 39.

Q21: In your views, what are the details of the intra-group transactions that should be included in the notifications to the competent authority?

We think that a notification is necessary as soon as intra-group transactions are started , enabling authorities to do their checks on practical/legal feasibility and adequate risk management, as a prerequisite for the exemption.
This notification could include the type/class of contracts involved as this may be relevant for these checks.
Notification of individual transactions to the authorities is unnecessary and would result in red tape.

II. CCP Requirements

Organisational Requirements (Article 24)

Q28: What are your views on the possible organisational requirements described above? What are the potential costs involved for implementing such requirements?

The requirement in par. 75 sub h – disclosure in "a language commonly used" plus "one of the official languages of the Member State" is unnecessary and onerous. "A language commonly used" is sufficient for information to foreign

parties. When the same language is regarded adequate for the information of domestic parties, there is no need for communication in an "official language of the Member State"; requiring a/the domestic language in addition to the "language commonly used" would be unnecessary: costly and without benefit.

Collateral Requirements (Article 43)

Q44: Do you consider that financial instruments which are highly liquid have been rightly identified? Should ESMA consider other elements in defining highly liquid collateral in respect of cash of financial instruments? Do you consider that the bank guarantees or gold which is highly liquid has been rightly identified? Should ESMA consider other elements in defining highly liquid collateral in respect of bank guarantees or gold?

We fully concur with the dimensions chosen for the criteria for "highly liquid". Anticipating on the parameters that should be set at a later stage, we think that ESMA should not be too restrictive in the eligibility of assets and instruments. A less-than-optimal (but still high) liquidity can be compensated by a haircut, which is common practice in various circumstances. We would welcome recognition and use of haircuts in this mechanism in order to avoid that the requirements are overly burdensome and that assets/instruments available for collateral become so scarce that the respective markets would be adversely impacted.
It will also be useful to recognise diversification effects at a clearing member level while setting specific haircut parameters, based on elementary risk diversification considerations.

Investment Policy (Article 44)

Q51: Do you consider that financial instruments and cash equivalent financial instruments which are highly liquid with minimal market and credit risk have been rightly identified? Should ESMA consider other elements in defining highly liquid financial instruments with minimal market and credit risk? What should be the timeframe for the maximum average duration of debt instrument investments?

Q52: Do you think there should be limits on the amount of cash placed on an unsecured basis?

The approach chosen seems to be built along the same lines as for collateral requirements. We tend to disagree with (part of) the outcome. Unlike for collateral, the tolerance for the risk taken by a CCP should be extremely low: for investments, any investment loss will be reflected directly in the CCP's books and hence hit the clearing members' positions, and these risks cannot be compensated by (higher) haircuts. CCPs should invest practically risk-free. Hence the possibility of claims on credit institutions (par. 135 sub 2c) is not justified.

III. Trade repositories

We would firmly stress that the recognition criteria and processes for (EMIR) trade repositories are streamlined to the largest extent with those of the ARMs under MiFIR.
This is very important from an operational point of view, because there are a mass of retail transactions in options and futures products (in scope of EMIR as part of Annex 1 section C financial instruments (4-10) of 2004/39/EC).

IV. Miscellaneous – competition elements

When a new instrument is elected for mandatory clearing, the requesting CCP will have a monopoly for clearing that instrument, at least for a particular period. We do not envisage a high number of potential CCPs competing for the clearing of the same (class of) instruments shortly after the first election. We think that ESMA should provide a mechanism preventing abuse of this monopolist situation.