DACSI

Consultation response DACSI 15-1105

From : DACSI

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What follows is the text of DACSI's response to the European Commission's Consultation of 21 May 2015 on the Review of EMIR (DACSI 15-2155), as submitted on 13 Aug.

Answers to questions for stakeholders

PART I - Questions on elements of EMIR to be reviewed according to Article 85(1)(a)-(e)

Introductory Comments
The questions in this section are targeted at gathering stakeholder views on the elements of EMIR that the Commission is mandated to consider in its report.

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.

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

Yes; it is essential that CCPs can have access to central bank liquidity.

ii. If your answer to i. is yes, what are the measures that should be considered and why?

Liquidity is a key factor in the core function of CCPs. Access to central bank liquidity facilities can be essential in providing/creating this liquidity. Therefore, CCPs should be granted access, should they require it, and should be able to put cash on deposit with central banks. In addition, deposits in currencies other than the applicable central bank's currency of issue should be allowed to count as part of the CCP's liquid resources, in order to align the CCP's liquidity and credit risk management.

However, central bank liquidity is one of multiple instruments in a CCP's liquidity management. A CCP can choose not to rely on central bank facilities while maintaining an adequate liquidity management framework. Hence, having access to the central bank should not be made compulsory.

In order to use central bank facilities a number of operational and formal requirements will have to be met. Having the status of bank or credit institution seems a sufficient condition for meeting these requirements, as current practice in some countries suggests. However, such a status should not be made a necessary condition: it obviously implies being subject to a regulatory regime that is not designed for CCPs. EMIR itself provides an adequate regulatory regime for CCPs: being authorised under EMIR should be sufficient for being granted access.

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Question 1.2: Non-Financial Firms

Article 85(1)(b) states that: " The Commission shall…..assess, in coordination with ESMA and the relevant sectoral authorities, the systemic importance of the transactions of non-financial firms in OTC derivatives and, in particular, the impact of this Regulation on the use of OTC derivatives by non-financial firms;"
Non-financial counterparties are subject to certain requirements of EMIR. However, such counterparties will not be subject to the requirements to centrally clear or to exchange collateral on non-centrally cleared transactions provided that they are not in breach of predefined thresholds, in accordance with Article 10 of EMIR. Further, it is recognised that non-financial counterparties use OTC derivative contracts in order to cover themselves against commercial risks directly linked to their commercial or treasury financing activities. Such contracts are therefore excluded from the calculation of the clearing threshold.

(b) Please explain your views on any elements of EMIR that you believe have created unintended consequences for non-financial counterparties? How could these be addressed?

The requirements under EMIR (transaction reporting, risk mitigation) are perceived as very complex and demanding by many non-financial counterparties (NFC).

As regards reporting: in general non-financial counterparties "below the threshold" (NFC-) do not have the expertise nor the facilities to report to trade repositories. In many instances, they mandate their (financial) counterparties to report on their behalf. Meanwhile, they remain responsible for reporting of their side of the transactions. This responsibility is both unfair and problematic for them, as they are not and cannot be equipped adequately.

As regards risk mitigation: in general NFC- counterparties do not have the expertise nor the facilities to comply with these requirements. E.g. portfolio reconciliations and prompt confirmations are simply too complex for a small (below the threshold) non-financial organisation.

In practice we see that many NFC- counterparties do not undertake the required risk mitigation measures, refuse to sign the contracts dealing with these requirements, and sometimes even refuse to apply for an LEI. This could be addressed by:

- transforming the bilateral reporting obligation into a single-sided obligation (reporting by the FC or NFC+ counterparties only); this will be elaborated under Question 2.3 (Trade reporting);
- excluding NFC- counterparties from the risk mitigation requirements;
- differentiating timelines for trade confirmation according to counterparty status: granting more time for confirmation of transactions with NFC- counterparties.

DACSI members face severe practical problems when counterparties do not have (applied for) an LEI - which happens frequently - , because they cannot report properly according to their regulatory obligations.
Substantial relief can be reached if this problem is removed from the EMIR context by excluding ETD transactions from the reporting obligation – as advocated for other reasons under Question 2.3.
For the remainder, alternative solutions are necessary to cope with situations where (EEA) counterparties do not have an LEI. A consequence of EMIR requiring derivatives transactions with any counterparty to be reported to Trade Repositories is that also non-financial counterparties (including small businesses) have an LEI. One way of addressing this is streamlining, where possible harmonising and reviewing the processes, conditions and fees of Local Operating Units (who issue LEIs) as to minimise the barriers to apply for an LEI for all legal entities.

We recognise that NFC- counterparties on aggregate are (or at least can be) systemically important. However, as a consequence of chosen definitions, individual NFC- parties are not systemically important. The total burden by current EMIR requirements on this group is very high, is not justified by the resulting information and the possible measures on micro-level, and is therefore disproportionate. Therefore, we propose the above measures.

PART II - General Questions

Definitions and Scope

Title I of the Regulation contains Articles 1-2.
Article 1 determines the primary scope of the Regulation, in particular with regard to public and private entities.
Article 2 provides definitions in use throughout the Regulation which further determine the scope of application of certain of its provisions.

Question 2.1

i. **Are there any provisions or definitions contained within Article 1 and 2 of EMIR that have created unintended consequences in terms of the scope of contracts or entities that are covered by the requirements?**

Yes.

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

The indirect definitions by reference to MiFID I lead to differences in classifications and categorisations. For instance, the question whether a specific transaction is FX spot or FX forward is answered differently in different countries. Evidently, this creates an unlevel playing field within the EEA.

We think this will be solved when these definitions are included in MiFID II/MiFIR. Until this is implemented, regulators and markets have to accept that counterparties in cross-border transactions are subject to different regimes with different classifications and consequent requirements.

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 significant ongoing impediments or unintended consequences with respect to meeting trade reporting obligations in accordance with Article 9 of EMIR?**

Yes.

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

Reporting obligations of non-financial counterparties below the threshold: Article 9 of EMIR
The reporting requirements for non-financial counterparties below the threshold are costly and very burdensome requirements for these smaller companies. Because of their lack of expertise and relevant (IT) systems, they outsource these obligations to financial counterparties with often costs attached and involving legal documentation (reporting agreements). In this view, the reconciliation with the financial counterparties' reporting has proved its non-efficiency. In addition, there are reconciliation obligations already under the EMIR risk mitigation requirements. We propose a less burdensome solution consisting of a **single-sided reporting** obligation which lies with the financial counterparties. This is in line with the U.S. principles under the Dodd Frank Act Title VII which entail a one-leg reporting obligation solely.

This would result in a smaller burden for non-financial counterparties under the threshold without impairing the transparency objectives and would ensure a global level playing field. This would also make it easier to align the EMIR reporting with the MiFID reporting, because the MiFID reporting is limited to investment firms. Article 9 of EMIR could be focused on financial counterparties and CCPs. Non-financial counterparties (at least those below the threshold) should be left out.

No reporting obligations for exchange-traded derivatives
Whilst it was originally envisaged that EMIR would cater solely for reporting of OTC derivatives as per the G20 principles, the obligation to report exchange traded derivatives (ETD) contracts was included at a very late stage of the trilogue process. The EMIR reporting regime is designed with OTC derivatives in mind. This has resulted in the inclusion of mandatory reporting fields that, whilst appropriate for OTC derivatives (such as "effective date"), are not a feature of exchange traded derivatives contracts. Such fields are nonetheless mandatorily required to be completed for exchange traded derivatives contracts; this has led to a market practice of populating those reportable fields with "manufactured" values. Also, the European Union is the only jurisdiction to include exchange traded derivatives within its reporting framework as a result of the 2009 Pittsburgh G20 Commitments.
As such we suggest the complete removal of exchange traded derivatives transactions from the EMIR reporting obligation.
Should the Commission be unwilling to adopt such a change, we would suggest seeking a move to single-sided (end-of-day) position reporting for exchange traded derivatives as well. This would significantly remedy the data quality issues experienced to-date.

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

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?

Yes.

(a) ii. If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?

Reporting requirements for derivatives and other financial products are currently implemented across the globe. These are not always aligned. This is creating difficulties for entities operating in multiple reporting regimes. We would encourage further alignment and harmonisation of reporting requirements as much as possible. Furthermore we would advocate the EC to expedite the adoption of equivalency decisions for jurisdictions outside the EEA. This is of vital importance for firms operating on a cross border basis. We support the current proposal to have a grace period of at least 3 years (or earlier when equivalence decisions have been taken) for transactions entered into between EEA and non-EEA parties to ensure for legal certainty and a global level playing field.

Article 39 of EMIR obliges non-EU clearing members to offer ISAs to their clients when providing clearing services in relation to CCPs. In her FAQ ESMA has already indicated that such can imply violation of particular non-EU home country legislation, e.g. the US bankruptcy code. As an effect, particular parties are not able to comply with the EMIR

requirements.

The lack of equivalence arrangements with regard to the clearing obligation adversely affects inter-affiliate transactions, by making single side clearing impossible. Therefore, we strongly suggest finalising the recognition process of art. 13 before the clearing obligation entering into force for category 1 parties.
As far as non-EEA branches of EEA entities are concerned, equivalence rules should be available where two EEA parties trade through their non-EEA branches. If such equivalence is not possible this will lead to possible conflicting rules and/or double regimes to apply.
Another significant issue is the absence of CCP equivalence rules, in particular in relation to CCPs in the US. The transitional CRR rules with regard to exposure on CCPs expire 15 December 2015. This can have a major impact on capital adequacy for EU clearing members and probably force them to significantly reduce clearing of US trades for their EU clients. The markets severely need equivalence rules before 15 December.

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

Yes.

(c) ii. If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?

Reporting transactions entered into with Third Country Entities (TCE's) remains difficult, as these non-EEA parties regularly do not provide to their EU counterparty the information that the EU party is obliged to report (e.g. LEI). It is also not expected to be available in the near future. As such counterparties are not directly in scope of the EMIR rules they still have an option to trade with other parties which are under no obligation to report such trades. This creates an unlevel playing field. Removing the LEI reporting requirement for TCE's would be welcomed. The disadvantages could be significantly reduced by permitting a single-sided compliance with the EMIR-obligations, hence avoiding the imposition of EMIR obligations on third country counterparties both regarding reporting and risk mitigation requirements

Specifically, the requirement to collect collateral from a third country counterparty (either FC or NFC) will disadvantage the EU based entities to the advantage of third country entities not required to collect margin. Trading derivatives with EU based entities will therefore become more expensive and more cumbersome unless and until all other countries implement similar regulations.

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.

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

Cost disclosure
The disclosure of clearing costs to EMIR clients as mentioned in article 38, paragraph 1 has more to do with investor protection rather than infrastructure. In addition this article is not limited to derivatives but to all financial instruments and also to retail clients (under the MiFID definitions). For these reasons we propose to include necessary cost disclosure (in terms of costs billed to clients/users) in the MIFID II requirements instead of in EMIR. This also prevents a fragmented approach, where clearing is seldom provided as isolated service, but mostly is an element of a broader service. *We therefore propose to delete article 38, paragraph 1 and insert necessary disclosure on clearing costs in the RTS of MIFID II (under transaction costs).*

Individual Segregated Account (ISA) for non-financial counterparties
We appreciate and understand how EMIR tries to limit systemic risks by introducing individual (ISA) and omnibus (OSA) segregated accounts. Article 39 sub 5 of EMIR obliges clearing members to offer a choice between individual segregation and omnibus segregation and to pre-agree with all their clients which level of segregation (individual or omnibus segregation) should apply. This is not limited to (OTC) derivatives, it includes shares, bonds etc, and applies to all parties subject to EMIR irrespective of their size and trading volume. The requirement to implement ISA (offering individual segregation) in addition to OSA accounts for equity cash products creates a heavy burden for the institutions offering the clearing of these products whereas, especially for smaller NFC entities, the (systemic) risks are limited. The costs of building and maintaining individual segregation are high. These costs will in the end be borne by the end clients, whereas it is unlikely that NFCs with low-value portfolios (in majority retail investors) will make use of such services because of the substantial costs relative to their portfolios. We feel there is limited added value in the obligation to offer individual segregated accounts for small retail clients.

The push towards central clearing is being interfered by CRR leverage ratio requirements
In general, DACSI notes a disconnection between EMIR and CRD IV/CRR. Whereas EMIR aims to promote and mandate central clearing, the CRD IV/CRR requirements on exposures to CCPs result in relatively high RWAs for GCMs. This affects the business model and economics of most clearers, potentially resulting in higher prices and entry barriers for end-users in order for European clearers to maintain a sustainable return on equity. Consequently, we have already seen a number of clearers exiting the market (e.g. RBS, Nomura, BNY Mellon and State Street). In addition, the leverage ratio under the CRD IV/CRR imposes restrictions in the capacity of GCMs to clear for their clients, as well fails to recognise the exposure-reducing effects of (segregated) margins with a CCP. We therefore invite the European Commission to address these issues in coordination with the EBA and other relevant international bodies.

Harmonisation of rules within EU
We see many new legislative initiatives for the financial markets within the EU which include reporting requirements (SFT, MMSR). We feel it is important to align these reporting requirements as much as possible and prevent double reporting. This would also minimise the cost burden and implementing pressure on parties that are subject to these rules.

Netting in unfriendly jurisdictions in the context of margin rules for non-centrally cleared derivatives
We would like to address the issue concerning 'netting unfriendly' jurisdictions. A large number of countries has not enacted netting legislation and consequently banks cannot grant netting (and collateral) benefits to counterparties in these jurisdictions. The current draft RTS sets out, in addition to the obligation to collect collateral, also an obligation to post collateral. This could be undesirable when facing counterparties in netting unfriendly jurisdictions. For example, EU banks deal with financial counterparties in Saudi Arabia on a 'gross exposure' basis, exposure may not be accounted on a net basis under Capital Requirements Regulation. Typically for derivative counterparties in these jurisdictions EU banks do not use collateral agreements for risk mitigation because of the risk of 'cherry-picking' from posted collateral. We request that EU counterparties should not be required to post margin (IM or VM) to counterparties in jurisdictions lacking netting legislation (and enforceability).