ISDA-AFME Comments on Polish Presidency text on EMIR dated *18 July*

26 July 2011

ISDA and AFME are pleased to have the opportunity to comment on the Polish Presidency text of 18 July on EMIR.

Please note that text in *italics* indicates either a new remark – often on a recent change in the text – or (where indicated) proposed text or text currently in the Council draft.

We would like to state support for the following new developments in the latest Presidency text:

- *The definition of "pension scheme arrangement" now includes also national pension schemes, which are recognised by national law. This shall allow EMIR to take into consideration the specificities of the national pension funds from certain Member States (Recital 23 (d)).*
- *Continued efforts to improve the wording on exemption of intra-group transactions from central clearing and bilateral margining (subject to certain conditions). Nevertheless certain concerns remain.*

Other comments

1-Scope (Article 1)

We note that the latest (Polish Presidency) text prescribes a reduced scope (only OTCs derivatives), but continue to support a broad scope of application for EMIR, including exchange-traded derivatives. We have already commented in detail on this, but, to summarise:

- A broad scope will 'future-proof' EMIR so that all platforms are required to clear contracts;
- A broad scope will address long-standing (for well over a decade) concerns held at EU level on the anti-competitive restrictions implied by vertical siloes, with consequent impacts for pricing;
- It is important to understand that expanding the product scope of EMIR to include exchange-traded derivatives **does not** amount to introducing full CCP interoperability for derivatives clearing at this time. A requirement for an exchange to provide trade feeds on a non-discriminatory and transparent basis to any authorised (for clearing of those products) CCP would ensure that two members of a given exchange could choose to use a CCP of which they

are both members to clear a trade, rather than being forced to use the venue's preferred CCP. This is not the same as interoperability, which would enable the parties to the trade to use **different** CCPs to clear their positions.

2-Intra-group transactions (Recital 21a, Article 2a, Article 6)

Intra-group transactions (IGTs) are of particular importance in Europe for financial institutions due to the preferences often expressed by clients and regulators in different Member States for these clients to deal with locally-based entities. Centralised portfolio management then allows a) banks to manage risk in a consolidated way, potentially allowing optimal pricing for the client and b) allows regulators to scrutinize a consolidated risk position in the financial institutions that they supervise.

We maintain that a clearing requirement for intragroup transactions would increase operational risk (because of the amount of clearing transactions with the CCP that would ensue, for different entities) without enhancing counterparty risk management in material terms.

We welcome the recognition (in Recital 21a) of the need for exemptions from clearing requirements for IGTs within mixed groups – a very important change for many companies.

We remain concerned that in the case of the conditions for exemption of IGTs entered into in non-financial groups (and indeed mixed financial/non-financial groups), the requirement that both non-financial entities should have the same risk management processes (Article 2a.1) would be problematic and seems excessive. This requirement could particularly cause difficulty in non-financial groups where risk is managed centrally in a dedicated treasury unit. That treasury unit is likely to have a more sophisticated risk management framework than the entities upon whose behalf it is managing the risk (this is quite reasonable, given the different commercial priorities for each type of entity).

We are also concerned that the text – because of problems in the definition of IGT for both financials and non-financials - may make it difficult for non-financial groups (or mixed groups) to qualify for exemptions from clearing and bilateral margining that financials may be able to qualify for (even if those IGTs are not intrinsically more risky than those entered into by financials).

We welcome the improvements in the text on the exemption for financial institutions from clearing of IGTs (Article 2a 2.).

We support efforts to facilitate total or partial exemption from bilateral collateralisation for intra-group transactions for financial and non-financial group entities established in the EU or in an equivalent third-country jurisdiction, subject to regulatory scrutiny, though are concerned that the reference to 'legal impediment to the prompt transfer of own funds or repayment of liabilities between the counterparties' may make this practically difficult, because of differences in national solvency laws which are of relevance for all financial transactions (and not only derivatives).

We continue to believe that where margin and associated collateral is required in intra-group transactions, it should be clear that associated collateral can be handled on a fully netted basis.

3-Indirect clearing (Article 3(2))

We maintain our concern that the current Council text may not sufficiently recognise the preferences of some clients to access clearing through banks which themselves are clients of clearing members. These clients should be allowed to continue with this preference, and the text of Article 3(2) should explicitly reflect this. *We note that the European Parliament text recognises this necessity.*

We have commented in detail on this point in a document on indirect clearing, accompanying this comment paper.

4-Backloading/Frontloading (Recital 12, 12c, Article 3 & Article 4)

We continue to believe that the frontloading requirement will – for reasons explained in previous commentaries – result in legal disputes and, as a result, a large number of non-compliance cases for national regulators to deal with. It will also be impracticable in relation to dealings with non-EU counterparties.

We believe that intention of the text would be more appropriately addressed by a reference in Article 3.1 c(ii) to a "*longer*" and not "*higher*" maturity.

However we believe that the clearing requirement should only apply to contracts entered into after the date from which a class of derivatives must be cleared following a decision on eligibility by ESMA.

We note that the European Parliament opposes both frontloading and backloading for these good reasons.

5-Phasing-in (recital 12, Article 4)

We continue to believe that the clearing requirement should be rolled out in an orderly fashion. While dealers and large clients will be ready to clear quickly, the practical application of the clearing requirements to smaller clients will be much more challenging, operationally (with associated risks), and in terms of the financial impacts felt by those smaller clients.

We note that the US rulemakers are applying phasing-in to clearing requirements under Dodd-Frank.
Article 4.2 of the 14 June text suggests allowance for phasing-in for 'frontloaded (i.e. contracts entered into between the date of entry into force of the Regulation and the date from which a clearing requirement as decreed by ESMA takes effect)' contracts and the category of counterparties to which the obligation applies. We believe that the clearing requirement should only apply to contracts entered into after the date from which a class of derivatives must be cleared following a decision on eligibility by ESMA, and that phased-in clearing requirements should be permitted for these contracts. It seems unwise not to give ESMA and the European Commission the flexibility to allow this, where they believe that it may be systemically or economically imprudent to require all derivatives and all counterparties in a particular class to be cleared on 'day 1'.

We note that the European Parliament believes that ESMA should be allowed to have the power to recommend phasing-in of clearing requirements.

6-Clearing criteria (Article 4)

We continue to regret the deletion of the eligibility criteria in relation to "levels of counterparty credit risk in the market, within the relevant class of derivatives and between classes of derivatives" and "the impact on competition" from the list of eligibility criteria for consideration by ESMA. We believe these were sound and helpful considerations for ESMA.

7-Bilateral risk mitigation (Article 6)

For remarks addressing intra-group transactions specifically, please see point 2.

We would welcome amendments here that would clarify that is *Initial Amount* that should be segregated at the option of the counterparties (to clarify, dealers should offer this option and clients should have a right to it), and not *Variation Margin* (which is passed back and forth frequently, subject to netting calculations). A requirement to segregate *variation* margin would have serious liquidity effects and is not generally sought by participants in derivatives business.

We recognise that the Council may feel that – if segregation of variation margin is not welcome by the broad universe of market participants – the reference to 'in accordance with their agreement' may satisfy concerns in this regard (Article 6.1b.).

We welcome the text's reference to the timing of the offer of segregation ("*if requested by the other party before the time of execution*"(Article 6.1b)), which is an important inclusion (failure to include this could result in legal disputes if counterparties cannot agree to the price associated with new requested segregation requirements. Such requests would also typically happen at moments of market difficulty, implying dangerous pro-cyclicality (liquidity effects)).

The text continues to state that mandatory risk mitigation requirements (collateral esp.) in Article 6 will only be applicable to non-cleared contracts entered into or after the entry into force of EMIR. While this improvement is welcome, we believe that mandatory collateral requirements should apply only on/after the date the clearing obligation takes effect.

We note that Article 6.1 applies to financial counterparties and all non-financial counterparties (without any qualification that the Article 6 requirements would only apply to contracts entered into by non-financials surpassing the clearing threshold). We don't believe this is the intention.

8-Transitional provisions

We believe that EMIR should include adequate transitional provisions dealing with the practical issues faced by market participants in complying. For example:

- It should be made clear that the reporting obligation does not apply to contracts entered into before the obligation comes into force which have been substantially performed (i.e. even though some residual obligations remain outstanding). It would be meaningless for reports to include transactions where the key economic terms of the transaction have been performed or have expired, merely because some other terms still continue to subsist (e.g. indemnification or other provisions).

- Where delegated or implementing acts are required in relation to a particular obligation, it should be made clear that the obligations do not arise until a specified time after those acts are adopted and published. For example, the obligations in article 5 on non-financial counterparties should not come into effect until a specified time after the adoption by the Commission of the technical standards setting the thresholds (or any revision of those thresholds). The first of these measures may not be adopted by the Commission and published until some time after the 30 June 2012 deadline. Non-financial counterparties will need some months to identify whether they are or are not subject to the resulting requirements. Similar issues arise in relation to the reporting obligation in article 7 where market participants will need time to build systems based on the final requirements as published.

- Even in those cases (such as article 6) where the provision could take immediate effect before the adoption of delegated acts, there should be a transitional period so that firms can take action based on the delegated acts actually adopted.

It is worth noting that the European Parliament text has the following wording dealing with this issue:

Article 71 (2a):

The obligations of counterparties under Articles 3, 6 and 8 shall become effective six months after publication of the regulatory technical standards, implementing standards and guidelines drafted by ESA (ESMA) and adopted by the Commission.

- The reporting obligation should only come into force some time after the Regulation comes into force to allow sufficient time for trade repositories to register under the Regulation. Otherwise, firms could be required to report under article 7 to national regulators and then repeat that reporting at a later stage when trade repositories register.

- The Regulation should specify a date from which the Regulation applies which is a reasonable time after the time that the initial delegated/implementing acts will have been adopted.

- The transitional provision in article 71(1) for CCPs should cover CCPs that are already subject to national supervision even if not technically authorised (e.g. in the UK, CCPs are exempt but not authorised).

- There should be express obligations on the authorities to allow adequate time for market participants to take implementing action, build systems, etc. e.g. where ESMA extends the clearing obligation or changes the information/clearing thresholds.

- There should be transitional provisions to deal with cases where a trade repository has registration or recognition withdrawn. Firms will need time before they are in a position to report to their competent authority.

- It should be made clear that nothing in the Regulation gives parties the right to terminate, amend or modify an existing derivative transaction (compare the Dodd-Frank Act).

9-Non-financials and hedging (Recital 16a, Article 5)

While we welcome the confirmation that non-financial institutions shall not be subject to any type of frontloading, we continue to have some related concerns about Article 5:

- We believe that the reference to Article 3 in Article 5.1(b) should be deleted in order to avoid any ambiguity.

- The mention of "*commercial activity or treasury financial activity*" reflected in Article 5.3 is still only partly reflected in Recital 16 and Article 5.4 (There is only reference to "*commercial activity*"). We advocate consistency on this point: maintaining the full wording "*commercial activity or treasury financial activity*" both in the recital and article.

We maintain that that reference only to interest rate, inflation, commodity and FX risk in recital 16a is inadequate for the purpose of the hedging definition. The use of CDS to hedge counterparty risk by non-financials is well known, and equity derivatives could legitimately be used to hedge risk in relation to employee share schemes, for example.

It is still not clear to us how firms are expected to know which non-financial counterparties have exceeded the threshold and hence are obliged to clear.

Article 5.3 seems to suggest that a non-hedging trade in one part of a non-financial group would prompt all transactions in the Group to have to be cleared, rather than just those in the affected entity. This seems unduly punitive in cases e.g. any energy utility company will have a trading arm and positions it takes could prompt the rest of the group to have to clear.

10-Collateral Requirements

Recital 37a still names several types of *'highly liquid'* asset which may be accepted as collateral, including: covered bonds, guarantees callable on first demand granted by a member of the European System of Central Banks (ESCB) and commercial bank guarantees from non-financial counterparties acting as clearing members.

We believe that determining the acceptability of collateral for the purpose of CCPs is a task that should be delegated to ESMA and the European Commission. We believe that giving CCPs the scope to provide for very flexible collateral requirements could – in practice – allow a race to the bottom to develop, with some market participants gravitating to CCPs implying lower costs but also lower risk management standards and therefore a much greater possibility of a CCP default with extreme systemic consequences.

We have commented in detail on this point in a document on CCP collateral requirements, accompanying this comment paper.

11- Access to a venue of execution (Article 8a)

We continue to believe that this provision should apply to derivatives and cash securities. This provision should require vertically integrated exchange/clearing house groups to share trade feeds. Again, we believe that the term '*smooth and orderly functioning of markets'* needs to be defined, in order to ensure that it is not used to block access when blocking access is not justified. We repeat that sanctions for non-compliance should apply.

As mentioned, unhealthy barriers to competition should not be allowed to persist if vertically integrated exchange-CCP groups are to become an increasing characteristic of the European post-trade landscape.

12-Third Countries (Article 3, Article 23, Article 1)

At the link please again find the letter drafted by 8 trade associations concerning extra-territoriality in EU and US regulation and which was sent in accompaniment to our comments on the last EMIR text.

In Article 3.1 b (iv), it is still not clear how firms can implement the clearing criterion with third country counterparties (in relation to determination of counterparties that would/would not be required to clear in Europe - different firms could arrive at different answers for the same third country counterparty). It is not clear upon whom the obligation lies to make the correct determination. Does this mean third country sovereigns would be exempt, since they would be if in the EU?

Article 23 appears to prohibit any non-EU CCP (regardless of product cleared) from providing services to EU clearing members or EU clients of EU or non-EU clearing members unless the CCP's regulatory regime is deemed equivalent.

Most non-EU organised markets and many non-EU OTC markets will have clearing arrangements of some kinds with a local CCP. It is possible that only a limited number of those CCPs will benefit from an equivalence determination. The problem of obtaining such a determination will be exacerbated if EMIR CCPs have to go beyond CPSS-IOSCO standards, unless the EU authorities take a flexible approach to equivalence determinations.

This means that EU investment firms would have to cease to be clearing members of many non-EU CCPs. But even more significantly, EU based investors will not (so it seems) be able to continue to be clients of EU or non-EU clearing members of those non-EU CCPs (although it is not apparent how this rule is to be

enforced). This would effectively make it impossible to operate an investment management business in the EU. Investment managers would need to move outside the EU to be able to trade on a large range of non-EU markets.

The problem is exacerbated because the regulation does not define what it means when it refers to a person "*established*" in the Union or how it deals with branches of entities:

- Entities "*incorporated*" in the EU are "*established*" in the EU. However, since a non-EU branch of an EU incorporated entity forms part of the same legal entity, it would appear that Article 23 prevents a non-equivalent non-EU CCP providing services to the non-EU branch of an EU bank. This would effectively make it very difficult for EU banks to operate a full range of services through their non-EU branches.
- If the term "*established*" also encompasses firms incorporated outside the EU, article 23 would have even broader impact. For example, a US bank that has a branch in the EU would then be established in the EU. A non-equivalent non-EU CCP would not be able to provide services to the US head office of that US bank (as it is part of the same legal entity that is "*established*" in the EU). If this were the case, this would be major disincentive to foreign banks to open branches in the EU.

It is not apparent whether the EU has addressed the possible WTO/GATS issues from shutting in its investors in this way ("prison Europe").

We regret the discrimination against non-ESCB sovereigns for the purpose of imposition of margin requirements. While we understand the reason for its insertion, we believe it is vital for EU and US regulators to work such extra-territorial aspects and divergences out in a calm way.

13- Withdrawal of Authorisation

Article 16 still does not consider the impact on clearing members of the withdrawal of CCP authorisation, nor does it contemplate clearing members being consulted prior to this withdrawal, which would be desirable. Similarly, it is not clear from Article 54a/55a and Recital 46 (withdrawal of registration of trade repository) what is intended to happen to the trade data held by the repository upon withdrawal of registration, and whether the repository would still be subject to the Article 66 obligation of confidentiality after withdrawal.

14-Transparency (Article 36)

We remain concerned about the following provision in point 1 of this Article:

*"A CCP **and its clearing members** shall publicly disclose the prices and fees associated with the services provided. They shall disclose the prices and fees of each service and function provided separately, including discounts and rebates and the conditions to benefit from those reductions..."*

If this is intended simply as an obligation for clearers to publish the CCP fee schedule, this is not a concern (these schedules are generally public). However we are concerned as to the potential for competitive distortions if clearing members are

- Expected to publish the exact fee they pay to the CCP (and disclose in which volume bracket they are as a firm), which seems to be the case (*'discounts and rebates'*);

- Expected to publicly disclose their own fees to clients (in addition to CCP fees).

We would underline here that clients will be able to choose between several different clearing members in complying with their clearing obligations, while there may be a more limited choice in terms of CCP services. It would seem reasonable that the focus, for the purpose of disclosure of fees, should fall on CCPs.

15-Participation requirements (Article 35)

Article 35.3 still doesn't specify what '*necessary additional financial resources'* clearing members must have in order to provide clearing for clients. Furthermore, Article 35.6 does not clarify what '*specific additional obligations'* are to be imposed on clearing members.

16-Segregation and Portability at CCPs *(*Article 37*)*

In Article 37.3a, no clarification has been made as to what "*reasonable commercial terms*" mean, or what authority will be setting such terms. For clarity purposes, we advocate for the commercial terms related to these segregation services to be established by the market (as the requirement will apply to all market participants, market forces should drive price competition).

The Article 37.5a contemplates a rehypothecation right for non-cash collateral held by the CCP under a security financial collateral arrangement. We do not support CCPs having a right to rehypothecate the securities collateral they receive, due to the resulting exposure of clearing members to the insolvency risk of the CCP and relevant third party counterparties. In addition, rehypothecation could result in higher capital charges falling on clearing members as their collateral is not bankruptcy remote.

We do not consider that it is optimal for the EMIR to seek to regulate clearing members (especially as not all of them may be in the EU). A change to the second sub-paragraph in Article 37(2) to begin "*A CCP shall require its clearing members to distinguish..."* could be considered.

In Article 37(2), the words "*with the CCP*" are missing.

In Article 37(3) the drafting appears to apply to CCPs clearing exchange-traded derivatives as well as OTC derivatives (the proposal is unclear because the definition of CCP is not limited to any particular category of financial instruments). However, it may not be practical for CCPs clearing for futures exchanges (or clearing members of those CCPs) to provide individual client segregation for futures business, given the numbers of underlying accounts. Therefore, it may be necessary to provide for differential treatment of futures business e.g. by adding the following sub-paragraph: "*This paragraph only applies to a CCP where it clears OTC derivatives contracts."*

In general, there is a need to consider the suitability of these provisions to clearing of different types of financial instrument. For example, these provisions may represent a practical challenge for cash securities clearing, where clearing members often hold stock in an omnibus account. Furthermore, if a clearing member uses a sub custodian (i.e. another bank in a different country) to hold its securities that

sub custodian would also be required to hold segregated accounts. This may be an unintended consequence.

A change could be considered to the second sub-paragraph of Article 37(3), to begin "*A CCP shall require its clearing members to offer...*", unless it is intended that this is optional for clearing members.

It is also not clear to us what is meant by '*the client's requirement*' in Article 37.3 – is this intended to reflect the CCP's margin requirements?

A number of *sell-side (dealer)* firms are concerned that they should not be required to post *'excess margin'* to CCPs, explaining that they fear that this could to lead to a situation where transactions are over-collateralised at the CCP level whilst clearing members' exposures to their clients are under-collateralised. They point out that clearing members will in practice have considerable intra-day exposure to clients, e.g. as a result of intra-day margin calls and/or the processing of transactions pending delivery of funds from clients, and that it is therefore reasonable to hold so-called "excess" collateral against such exposures as part of prudent risk management processes.

The term "*full segregation*" is still used in Art.37.4 (zero risk weighting for CCP exposure) instead of "*individual client segregation*" - presumably in error.

17-Default fund (Article 40)

Presumably the intention of "*A CCP may establish more than one default fund for the different classes of instruments it clears"* is for the CCP to establish one fund per class? This is not entirely clear from the drafting.

18-Clearing Member Default (Article 45)

Article 45.1 states that the CCP shall outline the procedures to be followed if it does not declare the default of a clearing member. It is not clear what is intended here and why a CCP would not declare a Clearing Default.

It is not clear how Article 45.4a and 4b are intended to interact. 4a refers to the distinction made in Article 37.2 between clearing member "House" vs "Client" accounts at the CCP and seems to assume that all clients would appoint the same back-up clearing member; 4b refers to the individual client segregation scenario, which is a subset of the Article 45.4a/37.2 scenario but is not carved out from it explicitly.

Article 45.3 requires a CCP to inform the national competent authority prior to declaring a clearing member default. This should be amended so that the CCP informs the authority 'as soon as practicable after the CCP declares' a clearing default. Our concern here relates to potential delay and information leaks leading to a Lehman-style run on the relevant clearing member.

19-Dissemination of information/data (recital 24, Article 7, Article 55, Article 67)

It is of concern that the disclosure of clearing member and derivatives contract information to national and other authorities for purposes unconnected with clearing appears to be contemplated in the text.

Recital 31 contemplates disclosure of information on derivatives to tax authorities; there are similar references in Article 67.3 (ESMA shall "*share the information necessary for the exercise of their duties with other EU relevant authorities")* and Article 67b (3) permits the authority receiving the information to use it for other purposes where ESMA consents to this. The information flow to and from ESMA regardless of confidentiality etc is also evidenced in Article 67b (4) and (5), Article 7.2 and Article 57a (Art 55c has penalties for non-compliance).

In relation to data protection, bank secrecy and confidentiality issues, it is not clear how effective the protections for clearing members in Recital 24 and Article 7.3 can be, since they attempt to cut across contractual confidentiality obligations as well as statutory data protection and bank secrecy obligations.

20-Central Bank Liquidity (recital 18a)

We note that the reference to "CCPs to be licensed as credit institutions" is maintained (between square brackets). This means that legal uncertainty persists - as we do not know if this license will be another requirement for CCPs before they can obtain the authorisation of national authorities.

For clarity purposes, we would like the words "on one or more currencies" reinserted, as this explicitly foresees the scenario that a CCP which has access to central bank liquidity facilities could be working in different currencies.

We remain cautious about forms of language addressing access to central bank liquidity or bank licensing for CCPs being inserted into EMIR, and are concerned that some variations on such language could undermine the operation of the single market, and Europe's open and competitive economy.

We welcome the intention expressed that measures to facilitate CCP access to central bank liquidity facilities should not encourage excessive risk-taking, and that such measures should respect the principles of non-discrimination and equal regulatory treatment across the EU.

21-Pension Funds (Article 68 and 71)

We broadly welcome the renewed recognition of the need for transitional arrangements for pension schemes as well as the flexibility being implied in the definition of pension schemes for this purpose.

<u>Annex:</u> Bullet point list of continuing to concern to ISDA in relation to EMIR text (as raised previously by ISDA)

26 July 2011

All comments relate to the Presidency compromise text of 18 July 2011

Territorial scope

- "Established": the text should make it clear whether "established" means having a registered office in the EU (as AIFMD does, for example), or whether it could include EU branches of non-EU entities.
- The text should also set out clearly the treatment of activities carried on in the EU by EU branches of non-EU entities, and should make it clear that it does not apply to non-EU branches of EU entities.
- The text should address the issue of how an EU counterparty subject to EMIR can establish whether or not a particular non-EU counterparty is one to which the clearing obligation is relevant.
- It should be made clear that EU counterparties are not required to clear derivative contracts entered into with entities to whom EMIR does not apply under article 1(4).

Maximum harmonisation

- The text does not state generally whether Member States may adopt or retain existing measures which are more extensive or stringent than those in EMIR. In general, EMIR should be a maximum harmonisation measure.

Article 2: definitions

- "central counterparty (CCP) ... becoming the buyer to every seller and the seller to every buyer": if there are multiple CCPs in a market (or if the market has a mixture of CCP and bilateral clearing), a CCP will not be the buyer "to every seller".
- The definition should also relate to transactions in financial instruments as defined in MiFID (as the authorisation requirement appears to be intended also to apply to CCPs for cash securities trades).
- A class of derivatives needs to be defined by more than "common, essential characteristics".
- It is not clear why EMIR discriminates against UCITS as opposed to equivalent funds organised under national law.
- Although the fund is the counterparty, there may be a case for including a provision imposing a duty on the operator of a UCITS or an AIFM for an AIF to take reasonable steps to ensure compliance with the clearing and reporting obligations that fall on the fund.
- 2(16): Article 1 of Directive 83/349/EEC does not define control. This definition should follow the wording in article 2(17)(b).
- 2(17)(b): if article 2(16) is redrafted to define "control", it will not be necessary to re-define it here.

- It would be helpful to include a provision under which the Commission can adopt delegated acts clarifying the definitions in article 2 (see e.g., article 4(2) MiFID) to help address the risks of unintended consequences.
- There should be an operative provision making clear that the clearing and reporting obligations apply to the counterparty to the contract, and not to anyone acting on its behalf. It may also be necessary specifically to address the position of "give ups" by executing brokers, to determine who the reporting and clearing obligations apply to.

Article 9 - Penalties:

- This should address jurisdictional issues (i.e., which member state's authorities can pursue enforcement action).
- It should be made clear that member states cannot impose penalties where the counterparty has taken reasonable steps to ensure compliance with the Regulation. It is inappropriate to impose strict liability, in particular where some provisions may be difficult to construe or apply in practice, e.g. a non-financial counterparty may find it difficult to assess whether his positions are or are not over a threshold.
- There should be an express provision making it clear that non-compliance with the Regulation does not invalidate any contract or give any party the right to rescind any contract (or to claim damages from any party).
- The competent authorities responsible for supervision of a financial counterparty are not necessarily the competent authorities that would be responsible for imposing a penalty. Non-financial counterparties are unlikely to have a supervisory authority.

Article 12 – Capital requirements

- The capital requirements should be aligned with those in the BCD.

Article 23 – Third countries

- If the provisions of the Regulation also apply to EU branches of non-EU entities then this provision may need amendment to reflect this (especially if "established" is defined by reference to the place of incorporation). Otherwise, non-EU CCPs would not be able to provide services to EU branches of non-EU entities.
- See the comments on territoriality above.

Title IV:

- It should be made clear that the obligations in Title IV only apply to authorised EU CCPs, not third country CCPs even if they are recognised under article 23. As stated in article 23(3), third country CCPs will be subject to equivalent national provisions in their home state and it would be duplicative to impose requirements on them under Title IV.

Article 25 - Senior Management and the Board

- It should be made clear how these rules apply in the case of entities with a supervisory and management board structure (e.g. one third rule should apply to aggregate number of members of the two boards).

Article 29 – Information to competent authorities

- These provisions should be aligned with the Acquisitions Directive provisions. However, the Acquisitions Directive is unclear as to whether it imposes a regime requiring prior approval of a change of control (there is no prohibition on completing the acquisition without approval). In addition, there is no penalty regime for those who contravene this provision.
- Art 29(2) – the second paragraph dealing with the notification by a person reducing a qualifying holding should be moved to separate provision. Under the Acquisitions Directive, a person reducing his holding only has to give prior notification. It does not need approval.
- Art 29(4) – there is no reason to extend the assessment period just because the vendor is outside the EU (compare Acquisitions Directive).

Article 31 – Conflicts of interest

- Art 31(3) – should also cover conflicts of interest with other companies that are subsidiaries of the CCP's parent company (a similar point arises in relation to article 31(5) and 66(5)).
- Art 31(5):
    - These provisions on CCP confidentiality will need further review and will need to be aligned with the similar provisions relating to trade repositories e.g. as regards regulatory access and use of information for other purposes.
    - This provision should be amended to read: "A CCP shall take all reasonable steps to prevent any misuse of the information maintained in its systems and shall take all reasonable steps to prevent …". It would be more appropriate for the CCP to be required to put appropriate measures in place to prevent use of information for other business activities, rather than impose a strict requirement on the CCP.
    - This provision should also make clear that a CCP may use information for other purposes with the consent of the persons concerned even if that information is sensitive (e.g. the CCP or an affiliate may also operate a trade confirmation service or other services).
    - In line 3, replace "recorded in one CCP" with "held by a CCP".

Title IV Chapter 2

- Not all of the obligations in Chapter 2 of Title IV are relevant to ancillary activities.

Article 38 – Exposure management

- The second sentence of this article is unclear as to whether it should impose an obligation on relevant third parties to make this information available to CCPs, or whether this is an obligation on CCPs to take reasonable steps to ensure that they have access to this information. This should be re-worded to impose a clear obligation on either the CCPs or relevant third parties.

Article 39 – Margin

- It would be helpful to distinguish the treatment of initial and variation margin in this provision.

Article 41 – Other financial resources

- Art 41(4) – The purpose of the second sentence is unclear. It should probably state that the rules of the CCP must ensure that there is a stated limit on the liability of a clearing member to provide additional funds in the circumstances stated in the first sentence.

Article 44 – Investment policy

- Art 44(1) – CCPs should be able to own land, buildings, computer equipment and other fixed and current assets. This provision presumably relates to the own funds held for the purposes of article 41(1).
- Art 44(3) – This should refer to securities of any member of the CCP's group (not just its parent or subsidiary).

Article 51 – Registration of a Trade Repository

- Article 51(1) should be limited to trade repositories that are legal persons established in the EU (the corresponding provisions in article 51(2) would be redundant).
- Article 51(1) (and article 52(1)) should make clear that the obligation only applies to those trade repositories that wish to provide services for the purposes of article 7. A person that carries on the activities that fall within the definition of a trade repository but does not wish to provide those services should not be required to be registered. This is significant because there may be businesses that provide related information or record keeping services in relation to OTC derivatives but which should not be required to be registered (albeit that market participants could not use those entities to satisfy their obligations under article 7).

Articles 55 to 61 and Title VII should only apply to registered trade repositories.

Article 55b - Fines

- Art 55b(1): It is inappropriate to impose fines where a person has taken reasonable steps to ensure compliance (particularly where the scale of the fines is so significant).

Article 55c – Periodic penalty payments

- Where fines are imposed on an individual, allowance should be made for their ability to pay and resources.
- Article 55c should contain provisions for regulatory technical standards.

Article 62 – International agreements

- Article 62 should also cover international agreements which address the access by third country regulators to information held by EU trade repositories.

Article 63 – Equivalence and recognition

- Article 63 only allows recognition of a third country trade repository where there is an international agreement (i.e. a Treaty) governing access to information. Given the constitutional issues in negotiating treaties in some countries (such as the US), it would be prudent to allow other means of satisfying the objective regarding access to information. For similar reasons, article 67 should create a mechanism allowing third country regulators access to information on appropriate conditions which does not depend on the existence of an international agreement.

Title VII

- Given that registered trade repositories may carry on other activities, the provisions of Title VII need to address those cases where its provisions only relate to the activities of a registered trade repository as such e.g. article 64(6) requires publication of prices and fees which is only relevant to the trade repository services.
- Title VII should only apply to registered trade repositories.

Article 66 – Safeguarding and recording

- Art 66(4) – This will need to should address cases where conflicting information is received from two or more parties.
- Art 66(5) – see comments on article 31(5).

Article 67 – Transparency and data availability

- This should address access by non-EU regulators.