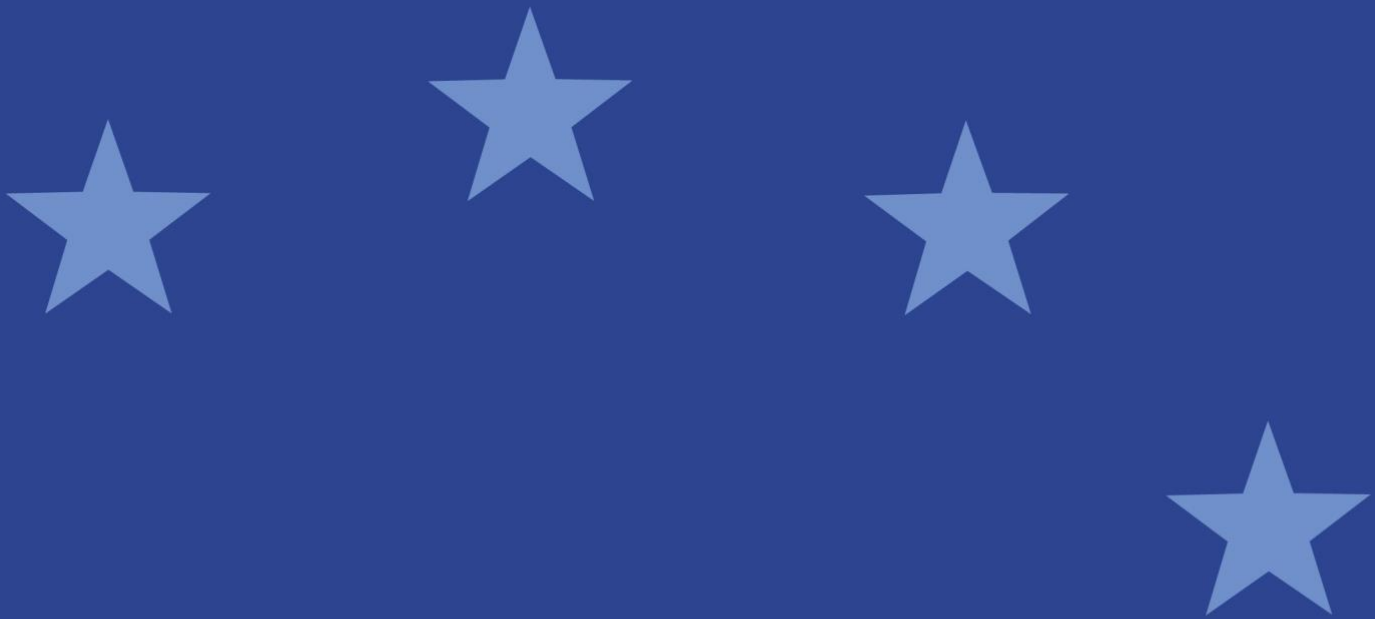




European Securities and
Markets Authority

Response Form to the Consultation Paper

**Draft RTS on safeguards for clients and indirect clients (Article 63(2) of the
CCPRRR)**



Responding to this paper

ESMA invites comments on all matters in this consultation paper and in particular on the specific questions summarised in Annex III. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **24 January 2022**.

All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input - Consultations’.

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation Paper in the present response form.
2. Please do not remove tags of the type <ESMA_QUESTION_SFSGS_1>. Your response to each question has to be framed by the two tags corresponding to the question.
3. If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.
4. When you have drafted your response, name your response form according to the following convention: ESMA_SFSGS_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA_SFSGS_ABCD_RESPONSEFORM.
5. Upload the form containing your responses, in Word format, to ESMA’s website (www.esma.europa.eu under the heading “Your input – Open consultations” → “Consultation on Safeguards for clients and indirect clients”).

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you

do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading [Legal Notice](#).

Who should read this paper?

All interested stakeholders are invited to respond to this consultation. In particular, this paper may be specifically of interest for EU central counterparties, clearing members and clients of clearing members.

General information about respondent

Name of the company / organisation	Futures Industry Association and International Swaps and Derivatives Association
Activity	Banking sector
Are you representing an association?	<input checked="" type="checkbox"/>
Country/Region	International

Introduction

Please make your introductory comments below, if any

<ESMA_COMMENT_SFSGS_00>

The Futures Industry Association (FIA) and the International Swaps and Derivatives Association (ISDA), together the Associations, represent the largest number of global and national participants in clearing, banking and financial markets. The Associations appreciate this opportunity to comment on this consultation.

We applaud ESMA for its enormous efforts and impressive work it has delivered on the consultations on CCP resolution, providing a thorough and comprehensive analysis for each of them.

Clearing members are supportive of the proposals how to distribute and pass on compensation for losses incurred in a fair, proportionate and transparent manner.

However, we believe that compensation should be distributed only to parties who participated in losses that led to actual and justifiable payment of compensation. Otherwise, a distribution would not be fair.

While they should be allowed to do so, clearing service providers should not be under any obligation to substitute the form of compensation to be passed on to clients. A market-based solution where clients would be able to sell any compensation and in doing so substitute its form, would instead be preferable.

Finally, we support Option 1 in the cost-benefit analysis with principle-based rules that are not overly prescriptive and give clients and their clearing service provider full contractual freedom to and agree on contractual terms to document the contribution pass-on.

This consultation response covers the positions of our members that are clearing members and their clients. The paper does not reflect the views of many CCPs, and many of the CCPs are in disagreement with the views expressed herein.

About FIA

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. Our membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 countries as well as technology vendors, law firms and other professional service providers.

Our mission: To support open, transparent and competitive markets, protect and enhance the integrity of the financial system, and promote high standards of professional conduct.

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 960 member institutions from 78 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.

<ESMA_COMMENT_SFSGS_00>

Questions

Q1 : Do you agree with the proposed conditions for fair and reasonable distribution of compensation? If not, please explain?

<ESMA_QUESTION_SFSGS_01>

We support a fair and reasonable distribution of compensation. We fully agree that clients and indirect clients should receive compensation if they participated in losses, and as long as these losses resulted in compensation payments under a NCWO claim.

This can be illustrated with two examples:

1. Clients and the clearing service providers incur losses from variation margin gains haircutting (VMGH) in excess of the limit in recovery. Additionally, the resolution authority enforces a recovery cash call for the clearing service providers. As the recovery cash call would have happened in recovery too, there will be no valid no-creditor-worse-off (NCWO) claim for this loss, even though that loss was incurred by the clearing service providers in a resolution scenario. Only the VMGH losses would justify valid NCWO claims.
2. Clients and the clearing service providers incur losses from VMGH, but within the limit in recovery. The resolution authority also calls the clearing service providers for a resolution cash call. In this case only the resolution cash call would justify a valid NCWO claim, but not the VMGH losses.

In both cases there are losses that do not justify valid compensation payments under the NCWO safeguard, and a distribution of compensation payments to all parties that incurred losses would in those scenarios not constitute a fair compensation, as in both cases some losses would not justify compensation payments under the NCWO safeguard. The first scenario would disadvantage clients, the second scenario would disadvantage clearing service providers.

A fair recompense should only have to be proportionate to losses which actually led to justified NCWO claims, but not all pass-through losses which a clearing member and/or client may suffer.

Also, we understand that a clearing service provider only compensates its direct clients. Should a client be a clearing service provider itself, it will need to reimburse its clients.

<ESMA_QUESTION_SFSGS_01>

Q2 : Do you agree with the proposed conditions for compensation on a pro-rata, fair and proportionate basis? If not, please explain?

<ESMA_QUESTION_SFSGS_02>

The wording of Principle 2 is not very clear. As laid out under question 1, compensation should be proportionate to losses that cause and justify compensation under the NCWO safeguard, therefore not to all losses that were passed through to clients. If compensation were to be distributed proportionally to meet all pass-through losses, including those which do not justify a NCWO compensation payment, the requirement of fairness set out in Principle 1 would not be met.

We would also welcome further clarity on what the expectations are on clearing service providers in terms of providing or passing on compensation payments to clients in scenarios where the client relationship has terminated prior to such in scope compensation payments having been made. We assume that where such compensation payments relate to the period where the client relationship was still in place, they will still have to be passed on.

<ESMA_QUESTION_SFSGS_02>

Q3 : Do you agree with the proposed conditions for set-off? If not, please explain?

<ESMA_QUESTION_SFSGS_03>

We agree with Principle 3.

<ESMA_QUESTION_SFSGS_03>

Q4 : Do you agree with the proposed conditions for segregation? If not, please explain?

<ESMA_QUESTION_SFSGS_04>

We agree with Principle 4 as market conditions after a CCP resolution could be very stressed, and segregation of the compensation, which might partially be client money, could provide comfort to clients that the funds are protected in the event of a follow-up default of their clearing member.

<ESMA_QUESTION_SFSGS_04>

Q5 : Do you agree with the proposed conditions for pari-passu? If not, please explain?

<ESMA_QUESTION_SFSGS_05>

Principle 5 should be amended to make clear that the allocation of compensation on a pari-passu basis should equally only apply to losses that lead to a justified claim for compensation under the NCWO safeguard. See also our example under Question 1.

<ESMA_QUESTION_SFSGS_05>

Q6 : Do you agree with the proposed conditions for equal distribution between different compensation tools and instruments? If not, please explain?

<ESMA_QUESTION_SFSGS_06>

Provided that compensation is allocated fairly (only for losses that led to compensation under the NCWO safeguard – see our responses to questions 1, 2 and 5), we agree that the different types of instruments should be divided equally between clearing service users. We believe that clearing service providers should however not be required to provide compensation in substituted instruments, especially not when doing so would be at the expense of and would be disadvantageous to the clearing service provider (notwithstanding the fact that the clearing service provider may provide transformation services to a compensated client).

We welcome the clause that the clearing service provider could “*distribute the instruments to an alternative addressee as directed by the clearing service user*”: we believe that this implies the clearing service user being able to sell the asset to another party, which provides the possibility of achieving the best market price. While we support the idea that a clearing service provider supports any requests from clearing users to substitute unwanted compensation instruments into a different type of instrument, we equally believe there should not be a legal requirement for the clearing service provider to do so. We believe the best outcome would be market based: allowing the client to sell whatever compensation is not desirable or would not be in line with its investment policies.

<ESMA_QUESTION_SFSGS_06>

Q7 : Do you agree with the proposed notice requirements? If not, please explain?

<ESMA_QUESTION_SFSGS_07>

We agree that there are clear benefits of a documentation trail and agree with the proposals in the consultation, other than the requirement of a simulation in Article 5 (2) d) “*A simulation evidencing how such compensation amount will be proportionally distributed between the clearing service users having made contributions*”. More clarity is required concerning this “*simulation exercise*” and what it entails and whether this would affect confidentiality requirements. Under no circumstances should one client be able to see position sizes or losses of other clients or their clearing service provider. A “*simulation exercise*” could be acceptable if it is performed with made-up numbers for illustration purposes only.

Equally, Article 5 (2) f) could lead to information about portfolios and losses of the clearing service provider and other clients being shared.

<ESMA_QUESTION_SFSGS_07>

Cost and Benefit Analysis Questions:

Q8 : Do you agree with the Option 1, if not please explain? Have you identified other benefits and costs not mentioned above associated to the proposed approach (Option 1)?

<ESMA_QUESTION_SFSGS_08>

We do agree with the principle-based Policy Option 1 and believe that this policy option would sufficiently ensure a fair, proportionate and transparent distribution of compensation (subject to the other comments made above). At the same time, we believe that there should not be an overly prescriptive requirement for clearing service providers and clients in relation to the documentation of the contribution pass-on to impact their contractual freedom to document this concept in their clearing documentation. In this context, we believe it is worth nothing that market standard documentation currently already provides for this pass-on mechanism by a clearing service provider to a client. Should the requirement become too prescriptive, it may cause a need to repaper a significant amount of client clearing agreements, which would create an unduly administrative burden.

<ESMA_QUESTION_SFSGS_08>

Q9 : If you advocate for a different approach, how would it impact the cost and benefit assessment? Please provide details.

<ESMA_QUESTION_SFSGS_09>

We support Option 1 and do not advocate for another approach.

<ESMA_QUESTION_SFSGS_09>