Reform of UK EMIR – ISDA and UK Finance proposal

20 December 2023

The International Swaps and Derivatives Association (ISDA) and UK Finance – hereby the "Joint Associations" – welcome the opportunity to comment on the Reform of UK EMIR.[1]

Our members do not request wholesale reform of UK EMIR. Rather, they seek a small number of clearly defined changes, mindful that implementation costs need to be justified by tangible benefits. EMIR 3.0 review should be closely considered by the UK authorities before committing to specific reform of UK EMIR.

Our members also seek certainty and permanence in relation to the current temporary exemptions and an end to the current dependency on equivalence decisions for certain provisions (e.g. the intragroup exemption).

We would like to recognise that this paper marks the start of our conversation on UK EMIR reform. It is possible that our members will present additional priorities in due course, and on these matters – and those in this paper - we look forward to an ongoing dialogue.

Note that this paper does not cover exchange-traded derivatives reporting.

The targeted list of 15 changes is provided below:

1. We recommend that there should be **permanent intragroup exemptions** from margin and clearing requirements for OTC derivative contracts between UK and non-UK group companies that do not depend on the making of equivalence determinations in respect of non-UK countries. We are pleased that HMT has extended the UK EMIR temporary intragroup exemption (TIGER) regime until 31 December 2026 to allow time for consideration of the reform of UK EMIR and highlight that this is a temporary solution until this reform can take place. We continue to advocate for permanent intragroup exemptions.

2. We also recommend that the **exemption from margin requirements for single stock equity options and index options should be made permanent.** Most major jurisdictions do not subject these instruments to margin rules, and this does not seem likely to change materially in the future. We note that the regulators have recently confirmed the extension of this temporary exemption from 4 January 2024 until 4 January 2026. ISDA's response is here.

   In general, a move by the UK to lessen the amount of expiry dates and make permanent certain temporary exemptions – in good time before the exemptions expire - would be welcomed by industry, who favour certainty.

[1] Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories as it forms part of domestic law of the United Kingdom by virtue of the European Union (Withdrawal) Act 2018 (EUWA).

For more on items 1 and 2, see paper and letter to HMT dated 22 December 2022 on reform of the UK EMIR intragroup exemptions[2].

3. We believe that the wording of **Article 13 ('Mechanism to avoid duplicative or conflicting rules')** should be amended so that UK firms would be better able to avoid the conflicting or duplicative clearing and margining requirements which may occur when trading with counterparties in other jurisdictions. Our proposed wording is set out in the detail below.

4. We believe that for OTC derivatives, **single-sided reporting could be introduced** for trades where:

   1) both parties are subject to UK EMIR reporting, and
   2) delegated reporting is being performed by one of those parties (either voluntary or mandatory delegated reporting).

   This could be done without compromising the quality of the data reported or reducing the market transparency available to regulators.

5. We also recommend **replacing OTC ISINs with UPIs**. This would solve the current shortcomings associated with ISINs and align the UK with globally recognised standards.

6. Always subjecting a **CCP's qualifying status in UK CRR[3]** to the CCP's recognition under UK EMIR is unnecessary. CCPs should continue to have qualifying status where they are recognised (or covered by the current temporary regime) under UK EMIR. However, where a CCP is not recognised (or subject to the temporary recognition regime that results in treating the CCP as recognised) and has not had an application for recognition denied or its recognition revoked, clearing members of such CCP should be able to perform their own analysis of whether the CCP is compliant with the Principles for Financial Market Infrastructures (PFMIs) and whether it could be treated as qualifying for capital purposes.

7. To increase the **transparency of CCPs' initial margin requirements,** in addition to user friendly margin simulators that provide the impact of either portfolio changes or projected market changes (stress scenarios) to margin, add-ons and default fund contributions, CCPs should also provide more transparency on the design of margin frameworks so clearing participants (clearing members and clients) can get comfortable with these models and can better understand how these models would behave under market stress.

8. To facilitate a practicable and harmonized global approach to initial margin (IM) portfolio management, we urge amending article 28 of the UK Margin RTS[4] ('Threshold based on notional amount') to the effect that **IM requirements no longer apply to existing derivatives transactions once one of the counterparties falls below the Average Aggregate Notional Amount (AANA) threshold**. IM requirements would instead only

[2] ISDA-Proposal-Reform-of-the-UK-EMIR-Intragroup-Exemption.pdf Scott-OMalia-Letter-to-authorities-re-Reform-of-UK-EMIR.pdf (isda.org)
[3] Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms as it forms part of domestic law of the United Kingdom by virtue of the EUWA.
[4] Commission Delegated Regulation (EU) 2016/2251 as it forms part of domestic law of the United Kingdom by virtue of the EUWA (see Article 28 Threshold based on notional amount - FCA Handbook).

apply to new uncleared OTC derivatives entered into from the compliance date associated with a subsequent AANA calculation period in which the group exceeds that AANA threshold.

9. The **methodology for the calculation of the clearing threshold** should be based on whether a derivative is cleared or not. This approach would recognise the benefits of clearing and be more in line with the approach taken for the calculation of the threshold for the exchange of IM (AANA calculation).

   In addition, the methodology for the calculation of the clearing threshold should be amended so that i) the NFC calculation is undertaken at an individual counterparty level rather than at a group level (although the hedging exemption should continue to apply to uncleared OTC derivatives entered into by an NFC to hedge group risks); and (ii) the FC calculation is undertaken at a group level but only in respect of uncleared OTC derivatives which have a connection to the UK (as described in the detailed comments below).

10. **Exempt all transactions with non-UK central banks, debt management offices and multilateral development banks** from obligations under UK EMIR (except for the reporting obligation which should continue to apply to the UK counterparty trading with the non-UK central bank, debt management office or multilateral development bank). This would be consistent with the approach taken in other jurisdictions and would reflect the level of risk posed by these entities.

11. **Reduce the barriers to using Money Market Funds (MMFs) as Initial Margin.** We ask that the UK Margin RTS be amended to allow the use of public debt constant net asset value MMFs as IM without a concentration limit. For other defined MMFs, the current 15% concentration limit should be raised and the Euro 10 million limit should be removed: as a practical matter it can equate to a concentration limit of below 5%, making MMFs too inefficient for use as IM.

12. **Amend the CCP collateral eligibility criteria to allow for MMFs, exchange traded funds and bonds.** This will allow CCPs to meet the needs of the market, particularly buy-side firms. In addition, conditions for bank guarantees to meet the highly liquid conditions are unduly restrictive: bank guarantees should not be subject to full collateralisation.

13. **Consider revising the UK Margin RTS on IM models** so that the model monitoring requirements apply only to the largest firms, with clients able to utilize the testing of their dealer counterparties. We argue that it is disproportionate and unnecessary to require smaller institutions to undertake model performance monitoring.

14. **Consider mitigation measures for firms facing hurdles applying the UK margin requirements when a jurisdiction changes netting status.** We welcome a discussion with the PRA/FCA on measures to minimize complexities for firms in the process of applying the UK margin requirements extraterritorially.

15. **Progress the implementation of a Post-Trade Risk Reduction (PTRR) clearing exemption.** The UK proposed to implement a PTRR clearing exemption in the Wholesale Market Review. We understand that both the FCA and the Bank of England have now been given powers to make these rules, with the FCA consulting further on them in their

Consultation Paper on bond and derivatives transparency. We would urge the Bank to set out its plans, should they require further consultation.

Detailed comments

1) Availability of intragroup transactions exemption

The UK EMIR framework provides exemptions for intragroup transactions from the clearing and margin requirements that apply to OTC derivative transactions. These exemptions recognise that exempting intragroup transactions from clearing and margining requirements would enable counterparties to take advantage of the efficiency of intra-group risk management processes without increasing systemic risk. However, the regime inherited from the EU makes it a condition of these exemptions for transactions between UK and non-UK group entities that there is an equivalence determination in place in respect of the relevant non-UK country. Although equivalence determinations are in place for some non-UK countries (including EEA Member States), there are many states for which no equivalence determination has yet been made or where the existing determination only applies to some categories of transactions. We also note that the European Commission's EMIR 3 legislative proposal removes an equivalence determination as a condition for exemptions for intragroup transactions from the clearing and margin requirements.

The Joint Associations propose that there should be **permanent intragroup exemptions from margin and clearing requirements for OTC derivative contracts between UK and non-UK group companies, that do not depend on the making of equivalence determinations in respect of non-UK countries.** This would enable firms who operate across jurisdictions to efficiently manage their business and would not steer assets/funding away from financing real economy activities to meet intragroup margining and clearing requirements. The EU and the UK regimes have, in effect, operated on this basis since the introduction of clearing and margin requirements in 2016. We are pleased that HMT has extended the UK EMIR temporary intragroup exemption (TIGER) regime until 31 December 2026 to allow time for consideration of the reform of UK EMIR and highlight that this is a temporary solution until this reform can take place.

We also note that the BCBS/IOSCO margin framework does not require intragroup IM (see p.21 FR03/2020 Margin requirements for non-centrally cleared derivatives). In any event, there are other measures already in place to mitigate the risks of uncleared or unmargined intragroup transactions for UK banks and PRA-authorised investment firms via the restrictions on intragroup large exposures, 'Pillar 2' requirements, recovery and resolution planning and – for UK ring-fenced banks – additional ring-fencing rules regulating intragroup transactions. The UK regulators responsible for the prudential supervision of other major categories of counterparties subject to clearing and margin requirements also have firm-specific intervention powers that can be used to mitigate excessive risks should they materialise. In addition, the UK smarter regulatory framework provides the UK regulators with sufficient flexibility to respond to any changing circumstances that suggest that new restrictions are appropriate.

2) Permanent exemption from margin requirements for single stock equity options and index options

The Joint Associations welcome action taken by the PRA and the FCA to extend the temporary exemption from the UK Margin RTS for single-stock equity and index options (‘equity options’) from 4 January 2024 until 4 January 2026.

Firms need a significant adaptation period if they are to implement new arrangements for bilateral margin requirements with their counterparties – the industry had been seeking at least one year's notice of the regulators intentions' before scheduled expiry of the derogation. Therefore, we welcome this temporary extension of the derogation for a two-year period.

Regarding the longer-term regime, **we strongly believe that a permanent exemption of equity options from the UK Margin RTS is warranted**. We note the regulators' intention to gather information on current market practices and risks posed by these types of products to inform their permanent approach and would be happy to discuss how ISDA can support that process.

As noted in CP13/23, the original temporary exemption was introduced to avoid market fragmentation, to ensure a level playing field across jurisdictions, and to avoid scope for regulatory arbitrage. This rationale remains valid, and since the exemption was introduced, there has not been a material change to the international position. The PRA refers to this rationale in justifying why it considers its proposal to temporarily extend the derogation to be compatible with supporting its new secondary competitiveness and growth objective, introduced by the Financial Services and Markets Act 2023 (FSMA 2023). **Making the exemption permanent would also be in line with this new secondary objective.**

For further detail, please see ISDA's response to the PRA and FCA's CP13/23.

3) Equivalence drafting under Article 13 of UK EMIR: preventing duplicative and conflicting requirements for UK firms competing internationally

Where UK firms could face duplicative or conflicting requirements relating to UK EMIR requirements (including but not limited to the margin requirements), Article 13 of UK EMIR enables deference to the other jurisdiction's legal framework where such jurisdiction has been determined equivalent, thus allowing UK firms to avoid having to comply (or, more importantly, forcing their clients to comply) with two sets of duplicative and/or conflicting rules.

We recommend that the requirement that one of the counterparties should be 'established' in the third country jurisdiction concerned should be amended.

If this term is interpreted to mean "incorporated" then there will be situations where a transaction is subject to duplicative and conflicting rules because a counterparty is subject to the rules of a non-UK jurisdiction, but the equivalence decision for that jurisdiction does not provide relief because neither party is incorporated in the relevant jurisdiction.

Two examples where this situation may arise in practice are:

- Where the relevant non-UK jurisdiction applies equivalent obligations to those under UK EMIR to foreign entities that are connected to the relevant jurisdiction in some way. For example, the US Prudential Regulators apply equivalent obligations to foreign entities with no local presence if they have a US affiliate or if they carry on business with local entities that requires them to be registered or authorised under local law. In this case, a UK entity may be subject to obligations both under UK EMIR and under US law, again regardless of the jurisdiction of its counterparty. The UK entity would not be able to rely on an equivalence decision for the US Prudential Regulators (should one be made in the future) when dealing with counterparties in other jurisdictions, as neither party would be incorporated in the US (nor does either party have a branch or any place of business in the US).

- Where the relevant non-UK jurisdiction applies equivalent obligations to those under UK EMIR to foreign entities with a branch in the relevant jurisdiction. For example, this is the case in Hong Kong. A UK entity with a Hong Kong branch would be subject to obligations both under UK EMIR and under Hong Kong law, regardless of the jurisdiction of its counterparty. The UK entity would not be able to rely on an equivalence decision for Hong Kong (should one be made in the future) when dealing with counterparties in other jurisdictions as neither party is incorporated in Hong Kong.

In both cases the Article 13 equivalence decision may give rise to an unlevel playing field between UK firms that are also subject to obligations under US or Hong Kong law (who would not be able to rely on the equivalence decision), and firms incorporated in the US or Hong Kong who deal with UK counterparties (who would be able to rely on the equivalence decision).

To give effect to the intent of Article 13 we would welcome: (i) amendment of Article 13(3) UK EMIR so that it reads "…where at least one of the counterparties is established in or subject to the equivalent requirements of that third country". In the EU, the co-legislators are considering amending Article 13 in this way.

4) Single sided reporting

For regulators to successfully supervise the derivatives markets it is important transaction information is reported accurately and consistently, and we acknowledge that the pairing and matching requirements of UK EMIR reporting helps verify both counterparties to a trade submit correct information. However, we believe that for OTC derivatives, **single-sided reporting could be introduced for trades where:**

1) both parties are subject to UK EMIR reporting, and
2) delegated reporting is being performed by one of those parties (either voluntary or mandatory delegated reporting).

This could be done without compromising the quality of data reported or reducing the market transparency available to regulators.

Delegated reporting (mandatory and voluntary)

The mandatory delegated reporting requirements – implemented as part of EMIR Refit – are designed to reduce the reporting burden on NFC- entities. An NFC- entity still retains some responsibility to ensure data is reported correctly, for example regarding counterparty reference data, which implicitly means an NFC- entity will need to remain informed of the UK EMIR reporting obligations.

Additionally, when an FC reports on behalf of itself and an NFC- client, the data populated in both reports originates from the same sources, i.e., the FC's trade booking/risk systems. As a result, the trade data for both messages will be the same (some information, such as the direction, would be the inverted values). This includes counterparty reference data now that an FC message will include NFC- entity data such as 'Nature of the counterparty 2', 'Corporate sector of the counterparty 2' and 'Clearing threshold of counterparty 2'.

Similarly, where there is a voluntary delegated reporting agreement in place between two counterparties (which could be between two FCs and not only between an FC and NFC), the counterparty providing the delegated reporting service would populate the messages for both entities using the same source data, including the counterparty reference data which needs to be provided by the counterparty delegating the reporting.

The only Counterparty 1 field that is not replicated as a Counterparty 2 reference data field is 'Directly linked to commercial activity or treasury financing'. Therefore, under a single sided reporting arrangement, there may be a need to consider adding this as a Counterparty 2 field as well, but only when the Counterparty 2 has delegated reporting (either voluntarily or via mandatory delegated reporting).

Taking the above into consideration, we propose that when an FC trades with an NFC- client, or when there is a voluntary delegated reporting arrangement in place, single-sided reporting where only the FC is required to submit a trade message will remove the remaining NFC- obligations while retaining data quality and transparency submitted to the regulators.

5) Replacing OTC ISINs with UPIs

It is important for regulators and market participants to navigate reporting requirements based on appropriate and international recognised identifiers, which reflect the economics of transactions accurately. Accurate identification of transactions and products enhances counterparty risk management and provides meaningful transparency to the market. The Unique Product Identifier (UPI) was defined by global regulators and is governed by the International Organisation for Standardisation under ISO4914, meaning that it is a suitable standard for OTC derivatives going forward. However, the UK has inherited the practice of using ISINs as product identifiers for OTC derivatives under UK EMIR and UK MiFIR[5] – although the FCA has proposed introducing the use of UPIs for OTC derivatives as part of its consultation on improving transparency for bond and derivatives markets.[6]

The Joint Associations recommend the replacement of OTC ISINs with UPIs for the purpose of reforming UK EMIR, aligning the UK with global standards, overcoming some of the shortcomings of the ISIN, and resulting in more meaningful reporting.

6) Amending the link between CCP recognition under UK EMIR and qualifying status under UK CRR

One example where additional flexibility could be added to support links between regulations is the link of the qualifying status for CCPs for the purposes of UK CRR rules to their recognition under UK EMIR (Article 25).

The current link is valuable and should be retained, as permitting clearing members to apply qualifying status to non-UK CCPs under UK CRR based on UK EMIR recognition avoids

[5] Regulation (EU) No 600/2014 on markets in financial instruments as it forms part of domestic law of the United Kingdom by virtue of the EUWA.
[6] https://www.fca.org.uk/publication/consultation/cp23-32.pdf

significant cost and complexity, compared to the alternative of requiring each clearing member to have to individually undertake their own analysis of whether the CCP complies with the PFMI requirements (as is the case in the US).

However, many non-UK CCPs do not wish to seek recognition in the UK under UK EMIR to be an eligible CCP for clearing OTC derivatives subject to the UK clearing obligation, to admit UK domiciled firms as clearing members or to provide clearing services to UK trading venues. Currently, if a non-UK CCP does not obtain recognition in the UK or loses temporary recognition under the UK temporary recognition regime (TRR) it will not be or will cease to be a qualifying CCP (QCCP) for the purposes of UK CRR rules. This will adversely affect a UK firm subject to UK CRR rules which indirectly clears transactions on the non-UK CCP through a local subsidiary or a third-party clearing member or which has a prudentially consolidated non-UK subsidiary that is a clearing member of the non-UK CCP or that otherwise clears transactions on that CCP. In these cases, the UK firm may be subject to significantly increased capital requirements (on a solo or consolidated basis) in relation to its exposures to the CCP because the CCP does not have qualifying status.

Some non-UK CCPs currently benefit from temporary QCCP status as a result of being in the TRR but may withdraw from the TRR if it becomes clear that their application cannot progress because HMT does not intend to make an equivalence decision (in time) in respect of the CCP's home country regime (and some non-UK CCPs are already in the run-off regime). There may be other non-UK CCPs which choose not to seek recognition in the UK in the future because it is not clear that an equivalence decision will be made in respect of their home country or simply because of the expense of seeking recognition (or concerns about the regulatory consequences of becoming recognised in the UK).

This creates a risk that UK firms will not be able to offer direct or indirect access to the full range of international CCPs that their UK and non-UK clients expect from a globally active firm. This would create an unlevel playing field in clearing at CCPs in these jurisdictions. These capital multipliers under UK CRR would be applicable only to UK firms and, via consolidation, their subsidiaries, but not to non-UK clearing members or non-UK owned clearing members in the home jurisdiction of the CCP. This would affect the ability of UK firms (or their subsidiaries) to compete in these markets. Changes that would make it easier for UK firms to deal with small third country CCPs would remove a lot of unnecessary friction, both for clearing participants and for regulators.

We propose a supplemental treatment under UK CRR, such that where a CCP is not recognised (or not subject to the TRR that results in treating the CCP as recognised) and has not had an application for recognition denied or its recognition revoked, clearing members of such CCP should be able to perform their own analysis of whether the CCP is compliant with the PFMIs and whether it could be treated as qualifying for capital purposes. This would be in line with the current practices in other jurisdictions e.g. the US.

7) Transparency of CCPs' margin requirements

The phases of high procyclicality in cleared margin and the inability of market participants to anticipate CCP margin calls have highlighted the importance of transparent CCP models. In addition to user friendly margin simulators that provide the impact of either portfolio changes or projected market changes (stress scenarios) to margin, add-ons, and default fund contributions, **CCPs should also provide more transparency on the design of margin**

frameworks so clearing participants (clearing members and clients) can get comfortable with these models and can better understand how these models would behave under market stress. While we recognise that global standard setters are working on additional, procyclicality specific transparency requirements, basic improvements to CCP transparency as above could be introduced now.[7]

8) IM phase out

We have identified global inconsistencies with respect to whether a group's AANA status change which allows a halt to the application of IM requirements to new derivatives transactions also applies going forwards to existing transactions which were previously made subject to regulatory IM requirements.

We believe that this approach, which is taken by most jurisdictions, is consistent with the intentions of the BCBS/IOSCO margin framework, which says in section 8.11 that "Applying the initial margin requirements to existing derivatives contracts is not required". Furthermore, allowing the IM obligation to fall away when a group does not have significant derivatives exposure aligns with the stated objective in the Executive Summary that the non-cleared margin requirements are intended to promote the "reduction of systemic risk".

However, the rules of a minority of jurisdictions, including the UK, require an opposing treatment whereby derivatives transactions which have been subject to regulatory IM requirements would remain subject to such requirements for the life of the transaction, notwithstanding that one of the counterparties falls below the AANA threshold (i.e., EUR 8 bn).

To facilitate a practicable and harmonized global approach to IM portfolio management, we **request amending Article 28 ('Threshold based on notional amount') of the UK Margin RTS to the effect that IM requirements no longer apply to existing derivatives transactions once one of the counterparties falls below the AANA threshold**.

9) Methodology for the calculation of the clearing threshold

In the EU, we have supported the suggestion by ESMA to amend the methodology for the **calculation of the clearing threshold to move from the current approach which counts derivatives towards the threshold if they are 'OTC derivatives' to the approach which only counts derivatives towards the threshold if they are OTC derivatives and not centrally cleared.** This approach would recognise the benefits of clearing and be more in line with the approach taken for the calculation of the threshold for the exchange of IM (AANA). It would also remove the need for an equivalence determination under Article 2a of UK EMIR in order to ensure that derivatives traded on non-UK futures exchanges are not counted towards the clearing threshold.

However, we do not believe that a trade should be considered centrally cleared for these purposes only if it is cleared by a CCP authorised or recognised by the regulators. This is not the approach required for the AANA calculation methodology and would add significant

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

complexity for the (by definition) small and non-systemic entities that must calculate this threshold, without the benefit of reducing systemic risk. Depending on the drafting, it might also add the complexity of including futures cleared at smaller CCPs for which the UK has not reviewed or granted equivalence (see comments on point on QCCP above).

We also believe the calculation methodology should be amended so that it does not apply to all derivatives activities of a group around the globe without restriction. Under the current method of calculation, all world-wide derivatives activities of members of a group count towards the UK EMIR clearing threshold, even if no UK-entity is involved. The current approach is over-inclusive and captures entities of no systemic relevance to the UK. This has a number of negative consequences. For example, a group may decide to curtail the derivatives activities outside the UK of its non-UK subsidiaries in order to remain below the clearing threshold. Conversely, non-UK entities may choose not to enter into derivatives transactions with UK counterparties in order to ensure that they do not have to calculate the clearing threshold (because they would have to identify and include derivatives transactions entered into by group members anywhere in the world even if no UK-entity is involved). In particular, this adversely affects the competitive position of UK commodities firms, compared to non-UK firms that are subject to less restrictive regulation.

We recommend that the calculation methodology is amended as follows:

- The NFC calculation should be undertaken at an individual counterparty level rather than at the group level (i.e., the NFC should only be required to include in the calculation uncleared OTC derivatives entered into by that NFC and not by any other group entities). However, the hedging exemption should continue to apply to derivative transactions entered into by an NFC to hedge the risks of any entities in its group. This approach would be consistent with the proposed approach of the EU under EMIR 3. It would significantly simplify the calculation for NFCs and exclude from the calculation OTC derivatives with no UK connection.

- The FC calculation should continue to be undertaken at a group level. However, only uncleared OTC derivatives with a connection to the UK should be included in the threshold:

  - For UK FCs, this means that they should only include in the calculation: (i) uncleared OTC derivatives entered into by that FC or by any other UK FCs in its group; and (ii) uncleared OTC derivatives entered into by any non-UK FC in its group provided that the counterparties to such transactions are UK entities.

  - When UK counterparties trade with non-UK counterparties, they must identify how the non-UK counterparty would be categorised under UK EMIR if they were established in the UK. For a non-UK FC to determine if it would be a large FC (FC+) or a small FC (FC-) if established in the UK, it should only be required to include in the calculation: (i) uncleared OTC derivatives entered into by any UK FCs in its group; and (ii) uncleared OTC derivatives entered into by that non-UK FC or by any other non-UK FC in its group provided that the counterparties to such transactions are UK entities.

This approach will ensure that only uncleared OTC derivatives with a UK connection are included in the calculation and would align the clearing threshold calculation for FCs more closely with the US approach.

Finally, **we recommend amending the definition and understanding of the term "commercial activity" with respect to hedging.** Hedging transactions are excluded from the calculation of the clearing thresholds under UK EMIR. However, we believe that the definition and understanding of the term of "commercial activity" in Article 10(3) of UK EMIR, which can be hedged through OTC derivatives transactions, is too narrow. It is unclear whether, where commodity derivatives are used as an ancillary part of the overall commodity business, transactions to hedge those exposures can be considered as falling within the carve-out for hedging transactions, and it would be useful to clarify that this can be within the scope of that carve-out.

It is important that hedging the commercial risk of a first (non-hedging) derivative transaction like a financial power purpose agreement entered into with a renewable producer with another second risk-reducing derivative transaction can be recognised as hedging, as economically the latter transaction can reduce the market price risk of the former. Hence, the definition and understanding of the term "commercial activity" could be clarified to cover the hedging of risks stemming from entering into financial instruments (commodity derivatives), when these financial instruments belong to the core commercial activity of an NFC-, e.g., those NFC-s whose core commercial activity is to deal in financial instruments as specialised energy and commodity trading firms do. For example, if an energy trader or another type of energy firm enters into a financial power purchase agreement, e.g., in the form of a financially settled swap fix-for-floating, with a renewable energy producer. These power purchase agreements are used as a means of investment financing as it secures the renewable energy producer a fixed margin for its produced power quantities. Therefore, the renewable energy industry would in our view greatly benefit from a clarification of the definition of underlying commercial activity to include financial instruments offered by NFCs as a risk management service to third parties for physical renewable energy project development.

10) Exempt all foreign central banks, DMOs and MDB from UK EMIR

The Joint Associations support insertion of a legally certain, full exemption of non-UK Central Banks (CBs), Debt Management Offices (DMOs) and Multilateral Development Banks (MDBs) from all UK EMIR requirements and for UK counterparties dealing with these CBs, DMOs and MDBs from all UK EMIR requirements except for the reporting obligation. This is in line with the rules of the CFTC and the US Prudential Regulators under the US Dodd-Frank Act, which exempts transactions conducted with (US-based and non-US based) CBs, DMOs and MDBs/International Financial Institutions (IFIs) from regulatory requirements such as registration, trading, clearing and margining.

While UK EMIR does give HMT the power to exempt specified non-UK CBs, this mechanism is cumbersome and lengthy. To date, CBs from only eight jurisdictions have been exempted (US, Japan, Australia, Canada, Hong Kong, Mexico, Singapore, and Switzerland), against, for instance, the more than sixty jurisdictions that ISDA has considered for derivatives trading when commissioning legal opinions. Applying the UK EMIR requirements to non-EU CBs and DMOs also does not appear to be justified given that the trading relationships with non-UK CBs and DMOs are adequately addressed under UK bank capital rules which set capital requirements where collateral is not held against positions. Banks' internal risk controls also limit exposure to CBs. If firms that are subject to UK EMIR are required to call margin from non-UK CBs and DMOs, while their competitors from other jurisdictions are not, they will find themselves at a competitive disadvantage. In general, such a competitive disadvantage is not justified by the level of risk associated with trading with these counterparties.

In respect of MDBs, both within and outside of the UK, there should be a complete exemption from for the MDBs from UK EMIR requirements, including reporting. This reflects MDBs' unique role and position in financial markets, as well as the wider global economy. This would not include UK firms dealing with MDBs, who would still need to report transactions with MDBs.

11) Collateral eligible to satisfy uncleared margin requirements

The UK Margin RTS specifies the types of assets that can be collected to satisfy regulatory margin requirements. We recommend reducing the barriers to using MMFs as IM such as the concentration limits applicable to UCITS. MMFs meeting strict criteria provide a secure and easier-to-segregate alternative to cash, addressing the difficulties noted in Recital 29 of the UK Margin RTS.

Another matter that should be addressed in the UK rules includes an amendment to allow the use of public debt constant net asset value MMFs as IM without a concentration limit. For other defined MMFs, the current 15% concentration limit should be raised and the Euro 10 million limit should be removed: as a practical matter it can equate to a concentration limit of below 5%, making money market funds too inefficient for use as initial margin.

12) CCP: eligible collateral and investment requirements

We believe that the CCP collateral eligibility criteria set out the UK RTS on Requirements for CCPs[8] should be amended to allow for MMFs, exchange trade funds and bonds. This will allow CCPs to meet the needs of the market, particularly buy-side firms. In addition, conditions for bank guarantees to meet the highly liquid conditions are unduly restrictive: bank guarantees should not be subject to full collateralisation.

We believe that a specific sub-set of MMFs which are of the same credit quality and as highly liquid as other instruments eligible for CCP investments, in particular PDCNAV MMFs, should be eligible instruments for investment by UK CCPs. These funds experienced high inflows and represented a safe haven in times of market turmoil.

We note that each CCP would define its own collateral eligibility rules within the framework set by regulation. Allowing a wider set of collateral in regulation would not mean that CCPs would automatically widen their rules but would allow them to come up with collateral eligibility rules that are better suited to the markets they clear and their clearing membership. These collateral eligibility rules would be signed off by the CCP risk committee and also the Bank of England as the supervisor of the CCP.

13) Narrow the scope of IM model requirements

The Joint Associations consider that the scope of the UK Margin RTS requirements on IM models is too broad. The UK Margin RTS currently apply related requirements around model performance monitoring to all counterparties and there is no differentiation based on size, systemic importance, or sophistication of firm. We argue that it is disproportionate and

[8] Commission Delegated Regulation (EU) No 153/2013 with regard to regulatory technical standards on requirements for central counterparties as it forms part of domestic law of the United Kingdom by virtue of the EUWA.

unnecessary to require smaller institutions to undertake model performance monitoring. This could ultimately discourage them from use of industry models, without enhancing the overall safety and soundness of the system, because their dealer counterparties will already be model testing vs. SIMM.

In line with the approach applied in the US (and in contrast to the prescriptive proposals of the EBA in the EU) we would encourage the PRA/FCA to consider revising the UK Margin RTS so that the model monitoring requirements apply only to the largest firms, with clients able to utilize the testing of their dealer counterparties. We welcome a discussion with the PRA/FCA to on how an outcome could be delivered.

14) Consider mitigation measures for firms facing hurdles applying the UK margin requirements when a jurisdiction changes netting status

As more jurisdictions develop their netting rules, there remains a potential extraterritorial cliff-edge effect. The Joint Associations welcomes that, in PS11/22, published last year, the PRA provided for an implementation period for firms to apply the margin requirements when a jurisdiction changes netting status.[1]

However, there are a number of scenarios which could mean that it remains impracticable to apply the UK margin requirements extraterritorially, even with an implementation period. A number of these were included in the ISDA response to the preceding Consultation Paper – CP11/22 - but another would be an absence of local margin rules.[2]

We welcome a discussion with the PRA/FCA on measures to minimize complexities for firms in the process of applying the UK margin requirements extraterritorially.

We thank you for taking the time to consider this paper. If you have questions on any of the issues addressed in it, we are happy to discuss them with you at your convenience.

[1] https://www.bankofengland.co.uk/prudential-regulation/publication/2022/december/margining-requirements-for-non-centrally-cleared-derivatives

[2] https://www.isda.org/a/vz3gE/ISDA-Response-to-FCA-PRA-Consultation-on-Margin-Requirements-for-Non-Centrally-Cleared-Derivatives.pdf

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