ISDA Safe, Efficient Markets

ISDA comments on EMIR 3 package[1] - February 2023

EXECUTIVE SUMMARY

1. ISDA fosters safe and efficient derivatives markets. We believe that the EU should work towards strengthening the competitiveness of Europe's growing derivatives markets by advancing the EU's attractiveness, reducing market fragmentation and upholding a global level playing field for European firms as laid out in our Whitepaper ''A Roadmap to Make European Clearing More Attractive"[2].

2. In the EMIR 3 proposal, the European Commission (Commission) took important steps to advance these objectives. Removing equivalence as a pre-condition to the availability of the intragroup transaction exemption will avoid market fragmentation and have a positive impact on how the EU is perceived in terms of market openness and attractiveness. Streamlining EU Central Counterparties (CCPs) supervisory procedures for launching new products and model changes will make EU CCPs more attractive and lead to more clearing in the EU.

3. Nevertheless, these positive measures have been largely undermined by the proposals to introduce the requirement for EU market participants to clear a proportion of their transactions in certain derivatives at active accounts at EU CCPs, as well as additional prudential measures (Pillar 2 tools). Measures to require clearing participants (clearing members and their clients, including end users) to use EU CCPs for a proportion of their business, especially if not adequately calibrated, are unnecessary, would make EU firms less competitive than third-country firms and would be damaging to the overall derivatives market, EU clearing participants and to the Capital Markets Union (CMU) more broadly. Ultimately, these measures, as proposed, will hurt European pension savers and investors**.** They may also have the undesired outcome of dissuading market participants from clearing transactions which would otherwise be clearable.

4. On the uncleared side, the removal of the only means EU firms have to prevent their clients from having to comply with two sets of rules with respect to risk management requirements is an unintended consequence of the deletion of Article 13 of EMIR. The lack of clarity on the scope and purpose of the power granted to the Commission to adopt a delegated act identifying additional third countries whose entities may not benefit from the intragroup exemptions will also introduce uncertainty for firms and is inconsistent with the aim of reducing market fragmentation.

5. Finally, there are two areas where the objectives of efficient, competitive and safe European derivatives markets could have been advanced further as part of this EMIR Review. Making permanent the current temporary exemption from margin requirement for equity options would ensure a global level playing

[1] "Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulations (EU) No 648/2012, (EU) No 575/2013 and (EU) 2017/1131 as regards measures to mitigate excessive exposures to third-country central counterparties and improve the efficiency of Union clearing markets (https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52022PC0697&from=EN)

[2] https://www.isda.org/2022/10/19/a-roadmap-to-make-european-clearing-more-attractive/

field and enable EU firms to continue to compete globally. Implementing ESMA's 2020 recommendations on Post Trade Risk Reduction (PTRR) services would significantly strengthen the resilience of Europe's growing derivatives markets by reducing operational and liquidity risk in derivatives business in the EU.

We support the measures that would strengthen the EU derivatives markets…

6. We strongly support the removal of equivalence as a pre-condition for the availability of an **intragroup transaction exemption from clearing and margining requirements** where one counterparty to the transaction is established in a third country. Removing equivalence as a pre-condition will avoid market fragmentation and have a positive impact on how the EU is perceived in terms of market openness and attractiveness. However, there is a lack of clarity on the scope and purpose of the power granted to the Commission to adopt a delegated act identifying additional third countries whose entities may not benefit from the intragroup exemptions. We believe that the power for the Commission to adopt such delegated act creates uncertainty and should be removed.

7. The proposal to decouple EMIR and CRR on the **CVA intragroup exemption** is a positive measure that will reduce market fragmentation. It will, however, be important to ensure equivalence decisions for CVA purpose are adopted as soon as possible covering a wide range of jurisdictions, in particular major jurisdictions. In that regard, we would note that currently the list of CRR equivalence decisions does not cover major jurisdictions like the UK.

8. **Streamlining the supervisory procedures** for the approval of new products and model changes for EU CCPs is a welcome step. It will allow EU CCPs to be quicker to market with innovative proposals, which is critical to the competitiveness of the EU clearing ecosystem.

9. We also strongly support the deletion of the requirement for the European Supervisory Authorities (ESAs) to issue Regulatory Technical Standards (RTS) on the supervisory procedures to ensure initial and ongoing **validation of risk management procedures/initial margin models**. The Commission's preference for issuance of guidelines or recommendations by the European Banking Authority (EBA) to promote a consistent application of the use of initial margin models will strengthen Europe's derivatives markets. Guidelines would provide a more dynamic and efficient method to implement and maintain procedures which are appropriate, practicable and can be legally enforced under established credit support documentation. We would however request that procedures which have already been established for initial model governance be deemed to be validated by the relevant competent authority[3].

10. We welcome the proposed methodology for the calculation of the **clearing threshold** (Articles 4a and 10), which moves from the current approach of whether a derivative is OTC or not to the approach of

[3] The use of initial margin models for calculating regulatory initial margin has been well established and subject to effective regulatory oversight since 2016. Major changes to model governance requirements would be costly, disruptive and may put EU counterparties at a disadvantage, particularly impacting the ability of smaller counterparties to use a risk-sensitive model for Initial Margin (IM) calculation.

whether a derivative is cleared or not. Allowing **bank guarantees** as eligible collateral for all clearing participants will be a helpful change for buy-side clearing participants in the energy sector.

11. We support the proposed amendments to the **UCITS Directive** to excludes cleared derivatives from the OTC counterparty exposure limits. This will incentivise clearing.

12. Finally, introducing an exemption from the clearing obligation where an EU counterparty enters into a transaction with a **Pension Scheme Arrangement** (PSA) established in a third country which is exempted from the clearing obligation under its national law preserves the competitiveness of EU firms. In order to fully benefit from this welcome measure, pre-emptive action should be taken to bridge the time gap between now and when EMIR 3 enters into force.

… but are concerned that some measures will significantly undermine the competitiveness of European firms.

13. We are very concerned with the **Active Account proposal,** which would significantly hamper the competitiveness of EU firms and be damaging to the overall derivatives market**,** especially if not adequately calibrated. The costs of these measures will ultimately be borne by European pension savers and investors. We do not believe that Tier 2 CCPs are a source of unmitigated financial stability risk for the EU and as such, measures to require EU firms to use EU CCPs for a proportion of their business are not justified.

14. For smaller players, being required to hold an active account at an EU CCPs (even without quantitative targets) will be disproportionate and costly. The Commission estimates that 40% of EU firms do not currently hold an account at EU CCPs for interest rate swaps[4]. The proposed reporting requirements are also overly complex and burdensome. They would require firms to set up new reporting systems, and will represent significant costs for smaller players, in particular clients.

15. Imposing an active account requirement with quantitative targets will make EU firms less competitive than third-country firms. There is also no evidence to support the idea that complying with quantitative targets would be workable. We urge policymakers not to introduce active account quantitative targets.

16. To avoid putting EU market participants at a significant competitive disadvantage, introducing a carve-out for market making activities and client clearing services from the requirement to clear a proportion of activities on an EU CCP is also necessary.

17. We believe that a proposal that is impactful for EU market participants should be supported by a robust cost benefit analysis but note that none has been produced. The proposal amounts to a forced relocation of some clearing activity as well as trading activity. The fact that costs are difficult to quantify does not mean these costs will not materialise.

[4] Page 9 of the Explanatory Memorandum on EMIR 3 proposal (EUR-Lex - 52022PC0697 - EN - EUR-Lex (europa.eu))

18. Finally, we are also concerned about the **introduction of Pillar 2 measures** to address a perceived concentration risk at CCPs. The scope and purpose of such measures are unclear, but they seem to go beyond the risk that ESMA had identified with regards to the reliance on services of substantial systemic importance at Tier 2 CCPs. The use of Pillar 2 measures to address a perceived and undefined concentration risk at CCPs contradicts the original intent of the G20 commitment to mandate the clearing of standardised OTC derivatives on CCPs to reduce financial stability risks and is not justified. Again, capital measures would only affect EU firms and could impact their competitive position in relation to non-EU firms.

19. While we welcome the de-linking of an equivalence determination from the availability of the intragroup transaction exemption, we are concerned that the full **deletion of Article 13** of EMIR (mechanism to avoid duplicative or conflicting rules) removes the only means EU firms have to avoid requiring their clients to comply with two sets of duplicative rules with respect to margin/risk management requirements. As such we believe some mechanism should be retained in the Level 1 text to enable avoidance of duplicative or conflicting rules.

20. We support **transparency of margin models for clients**, but believe that most of this transparency should come from CCPs, through improved implementation of the existing transparency requirement applying to CCPs under current Article 38(7) of EMIR. We are concerned that the proposal expects EU clearing members to provide clients with information that they do not have, for instance the results of simulations of margin requirements under different scenarios including stressed scenarios. In addition, we would encourage EU authorities to wait for CPMI and IOSCO policy proposals with regards to margin transparency.

In addition, we urge policymakers to introduce further measures to promote a global level playing field and resilience of the derivatives market

21. Making the **exemption from margin requirements for single-stock equity options and index options permanent** is essential to preserve the global level playing field and protect the competitiveness of EU firm, given that in some major jurisdictions equity options are not subject to equivalent margin requirements. We believe that the Commission should have taken the opportunity of the EMIR review to give a mandate to the ESAs to make the exemption permanent in the Margin RTS[5].

22. We also believe that the Commission should have seized the occasion to incentivise the use of PTRR techniques by implementing ESMA's 2020 recommendation that **non-price forming risk reducing output transactions that result from PTRR exercises should benefit from a conditional and limited exemption from the EMIR clearing obligation.** PTRR services would strengthen the resilience of Europe's growing derivatives markets significantly by reducing operational and liquidity risk in derivatives business in the EU.

[5] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02016R2251-20210218

SUMMARY OF PROPOSED KEY CHANGES

23. The following is a summary of our main proposed changes. A detailed explanation of each proposed change can be found further down in the section "Key Concerns".

Active accounts and Pillar 2 capital measures

Active accounts:

- Should policy makers decide to require active accounts, they should not attach a minimum activity level to the requirement.
- Should policy makers decide to require active accounts with a minimum activity level, the mandate to ESMA in the proposed Article 7a(5)(a) should be amended so that:
    - ESMA is not required to set the level of proportion of activity in each category of the derivative contracts in a manner that ensures that the derivatives contracts are no longer of substantial systemic importance; and
    - The safeguards in recital 11 should be moved to proposed Article 7a(5)(a) such that ESMA is required to consider the costs and impact on competitiveness of market participants
- In the proposed Article 7a, the requirement to clear a proportion of transactions away from Tier 2 CCPs should include recognised Tier 1 CCPs, and not only EU CCPs.
- The proposed Article 7a should be amended so that the active account requirement only applies to contracts which are subject to the clearing obligation.
- Exemptions for market making and client clearing activities should be introduced in the proposed Article 7a.
- Proposed Article 7a should exempt transactions that result from default management (both clearing members and clients) and compression/PTRR services.
- The timelines set by the proposed recital 11 (and those suggested in the cost benefit analysis report) for the effective reduction of exposure are overly ambitious and not realistic. If policy makers impose quantitative requirements for exposure reduction, they should set a realistic date for the effective reduction of exposure. Market participants will also need early clarity on the extension of the equivalence decision for UK CCPs beyond June 2025.
- For policymakers to have a full picture of the costs involved, especially for European banks, the Commission should provide a robust cost/benefit analysis of both the requirement to hold an active account with an EU CCP and to conduct a proportion of activity at EU CCPs.
- The proposed Article 7b should be amended so that there is a general disclosure requirement on clearing members to inform clients about the possibility of clearing at an EU CCP, and not required on a transaction-by-transaction basis as that is incompatible with the clearing workflow and market practices.
- The scope of the proposed reporting requirements under Article 7b(2) must be significantly narrowed to take into account the costs and operational burden for market participants, especially clients.

Pillar 2 measures:

- All amendments to the CRD and IFD in relation to concentration risk to CCPs should be deleted as Pillar 2 measures are an inappropriate tool to address the risk that ESMA has identified in relation to exposures to services of substantial systemic importance. These measures will harm the competitiveness of EU banks and contradict the intention to encourage central clearing.

Single-stock equity options and index options

- A recital should be introduced in EMIR 3 that recognises that in some major jurisdictions single-stock equity options and index options are not subject to margin requirements, and that to avoid market fragmentation and to ensure a global level playing field, it is appropriate to permanently exempt these contracts from the margin requirements in the Margin RTS.

Post trade risk reduction (PTRR) services

- As recommended by ESMA, and supported by the ESRB, the non-price forming risk reducing output transactions that result from PTRR exercises should be subject to a conditional and limited exemption from the EMIR clearing obligation.

Intragroup transaction exemption

- The power for the Commission to adopt a delegated act identifying additional third countries whose entities may not benefit from the intragroup exemption creates uncertainty and should be removed. Firms should also not have to reapply for intragroup transaction exemptions but should be able to rely on the existing ones (grandfathering).

Mechanism to avoid duplicative or conflicting rules (Article 13)

- The deletion of Article 13 should be accompanied by an alternative mechanism for firms to avoid having to comply with duplicative or conflicting rules going forward.

Transparency of margin models for clients

- The onus for providing client with transparency on CCP margin models should be placed on CCPs. Clearing members should not be required to provide clients with transparency on CCPs margin models above and beyond what they receive from CCPs.

KEY CONCERNS

KEY CONCERN 1 – EUROCLEARING PROPOSAL

24. Holding an active account in the EU can be good risk management. Making this a requirement, however, will disadvantage EU banks, especially if the requirement includes minimum activity levels not adequately calibrated in terms of scope and levels. ISDA's "Technical Paper on Active Accounts"[6] sets out in detail the operational complexity of different policy options.

25. Even though the active account tool set out in the proposed Article 7a would require the UK CCP equivalence decision to be extended beyond June 2025, it effectively amounts to a forced relocation of some clearing activity, imposes significant costs on EU market participants and puts them at a competitive disadvantage.

26. This will put the EU framework at odds with international standards, which have recognised the benefits of deference and cross-border activities. IOSCO's June 2020 report on deference noted that good and effective deference practices can support the mitigation of systemic risk and support financial stability, prevent unintended and potentially harmful regulatory-driven market fragmentation, and ensure a level playing field between domestic and foreign market participants. As such, we would encourage EU authorities to adapt ESMA's crisis management toolbox – which the current proposal already does – and ensure that an effective cooperation framework with UK authorities is in place.

Financial Stability and Risk Considerations

We believe that the Commission considerably overstates the risk of clearing at Tier 2 CCPs. The current EMIR recognition framework for Tier 2 CCPs, as well as proposed additions to ESMA's supervisory toolbox, should go a long way in addressing the concerns identified in ESMA's 2021 assessment on UK Tier 2 CCPs – such that the proposals appear disproportionate.

27. We believe that the Commission considerably overstates the risk of clearing at Tier 2 CCPs and as such, measures requiring clearing participants to use EU CCPs are not justified. EU authorities should take comfort from the fact that the UK recovery and resolution provisions are very similar to the EU ones. We note in particular that the UK has proposed a very strict no-creditor-worse-off construct that ensures clearing participants are treated fairly. EMIR 2.2 also requires Tier 2 CCPs to comply with EMIR and gives significant powers to ESMA over Tier 2 CCPs. The proposed Article 25(7b) would also grant ESMA additional powers over Tier 2 CCPs' recovery and resolution plans, including in a crisis scenario.

28. The example given in the impact assessment report whereby "*changes in the eligible collateral, margins or haircuts […] may create feedback loops that negatively impact sovereign bond markets, and more broadly financial stability*"[7] refers to issues in 2011, long before the first version of EMIR was in force,

[6] https://www.isda.org/2022/10/24/technical-paper-on-active-accounts/
[7] See page 11 of the Impact Assessment Report: EMIR 3.0 (europa.eu)

and long before EMIR 2.2. Tier 2 CCPs today would have to follow anti-procyclicality rules. The role of ESMA over these CCPs would also mitigate such risks.

29. At the same time, the Commission fails to consider the new market fragmentation risks that its proposals may cause. Market fragmentation could affect liquidity, not only adding to cost, but potentially also hindering firms from entering hedge positions or unwinding transactions in time and at the right price.

30. We are also concerned about market structure. We understand that, due to the nature of clearing mandates, EU clients are mostly asset managers, which tend to have similar portfolios with similar directionality. These trade flows are at present balanced by global firms with discretionary assets that provide flow in the opposite direction, enabling European firms to have balanced portfolios. These global firms (e.g. hedge funds) are unlikely to move to EU CCPs given they trade USD and euros and benefit from having them cleared together and there is no liquidity in EU CCPs for USD. If European firms can no longer access (or have only limited access) to deal flows from these global firms, European firms could struggle to maintain balanced portfolios and to manage their risk, potentially having to buy expensive hedges from global competitors.

31. Global firms will likely intermediate across Tier 2 and EU CCPs by providing hedges to users of the EU CCP which these global firms in turn hedge at the Tier 2 CCP. This could lead to large, directional positions at the EU CCP with an opposite position at the Tier 2 CCP, posing considerable risk to these firms, especially in stressed markets. These firms would provide the service of bridging between the EU CCP and the Tier 2 CCP without having all the necessary information to manage this risk.

32. Requiring Pension Scheme Arrangements (PSA) to clear could also lead to financial stability issues in a situation like the COVID crisis in March 2020. PSAs hold high-quality liquid assets (HQLAs) that, in normal market conditions, can be converted into cash. However, these HQLAs would be subject to higher volatility in stressed market conditions. As a result, PSAs may not be able to generate sufficient cash to meet VM calls. We believe that PSA should benefit from liquidity safeguards if they are required to clear.

Impact on the Capital Market Union (CMU)

33. We fully support the CMU and believe that the EU requires liquid, efficient, resilient and vibrant markets that enable EU corporates to raise money when needed. While we agree that “efficient and resilient derivatives markets are essential for the function of the CMU”, it is possible to have liquid, efficient, resilient and vibrant markets without forcefully onshoring clearing. The chart in Annex 1 shows that Eurex already has a material market share in Euro-denominated OTC Interest Rate Derivatives.

34. The active account proposals undermine the objective of the CMU, by encouraging non-EU clients to shun EU clearing members, thereby reducing the choice available to EU clients and clearing members vs their international peers – introducing frictions and potential costs, in contradiction with the stated objective to foster the competitiveness of Europe’s derivative markets.

35. Disadvantaging EU firms compared to their global competitors will make the EU market less liquid, efficient, resilient and vibrant. Strategic autonomy is not supported by making EU firms uncompetitive and creating overreliance on global banks and other financial firms.

Proportion of activity to be cleared at EU CCPs

Setting minimum proportions of trades to be cleared at EU CCPs will fragment markets, disadvantage European firms and hurt European pension savers and investors. Should policymakers decide to require active accounts, they should not attach a minimum activity level to the requirement.

Should policymakers decide to require a quantitative target, the mandate of ESMA in proposed Article 7a(5)(a) should be amended so that ESMA is not required to set the level in a manner that ensures that the derivatives contracts are no longer of substantial systemic importance; and ESMA is required to consider the costs and impact on competitiveness of market participants.

36. Holding accounts at multiple CCPs is expensive and operationally complex and we believe a significant number of firms will feel that it is disproportionate to maintain an active account at both an EU CCP as well as a Tier 2 CCP. The Commission has not provided sufficient evidence that, if active accounts should be introduced at all, its policy objective would not be met by requiring firms to hold an account at EU CCPs (without any quantitative target other than demonstrating that the account is active including daily VM payments) thus incentivising firms to move to EU CCPs in order to mitigate the cost implications and operational complexity of having two accounts.

37. While details are unclear, the mandate set to ESMA could result in a very large proportion of trades being required to be cleared at EU CCPs. ESMA is mandated to specify in a RTS what the proportion of activity to be cleared at EU CCPs will need to be. This proportion needs to be set at a level that results in such services no longer being of substantial systemic importance. At the same time, ESMA's calibration of the proportion is not supposed to go beyond what is necessary and proportionate to reduce clearing in the identified clearing services at Tier 2 CCPs concerned. At present, neither policymakers nor market participants have visibility of the level at which a substantial systemic importance commences or ceases to exist based on the existing ESMA report[8] which in the key areas is heavily redacted.

38. We do not support setting a minimum proportion of trades to be cleared at EU CCPs but, if authorities pursue this policy option, the minimum proportion should be set at a level that does not disadvantage EU firms in global markets. These levels should be transparently determined by ESMA with support from market participants and be phased in over a sufficiently long timeframe. ESMA should not be required to set the level in a manner that ensures that the contracts are no longer of substantial systemic importance.

Practicability of setting a minimum activity level

[8] https://www.esma.europa.eu/file/122182/download?token=Rg05gNwD

39. EU firms will have to set up processes to make sure that they comply with activity level targets. This will likely require a feedback loop of current activity level targets to traders. Larger clearing participants will likely try to integrate the usage into trading systems, so traders know whether they are on track to be compliant with targets. Including this information in trading systems would require a significant uplift to systems to allow for real time monitoring of CCP usage, and would require a sufficiently long implementation period to allow for market participants to establish monitoring processes. Market makers will have to adapt the way they stream prices to trading venues. The main way to direct flow on trade venues to EU CCPs will be to quote worse prices for transactions cleared at other CCPs, making EU firms less competitive. Overall, EU firms will have to deal with additional complexity in trading while global competitors will not be subject to such restrictions. This will disadvantage EU firms in global competition and could cause higher cost for end-users.

40. If policymakers opt for quantitative requirements, the requirement to clear a proportion of trades at EU CCPs should only apply to new transactions[9], as setting a requirement to move legacy trades would be significantly disruptive for market participants, who would be exposed to market risks, operational risks and would potentially lose hedge accounting treatment when moving positions held for hedging purposes.

41. It will be very difficult for ESMA to define the minimum proportion of contracts cleared at EU CCPs in such a way that these services will no longer be of substantial systemic importance. Many measures that could be used, like trade count or nominal value that are sensitive to FX rate changes, expiring transactions and compression. It is also unclear how any set proportion of contracts (a flow measure) could affect the status of substantial systemic importance (a stock measure). Any proportion will be difficult to define, to comply with and to supervise.

Scope of active accounts

The requirement to clear a proportion of transaction away from Tier 2 CCPs should include recognised Tier 1 CCPs, and not only EU CCPs, and should only apply to products which are subject to the clearing obligation under Article 5 of EMIR.

42. We believe that the requirement to clear a proportion of transaction away from Tier 2 CCPs should also allow recognised Tier 1 CCPs to be included as an alternative, and should hence not be limited to clearing at EU CCPs only. As the rules are currently worded, it seems that the main aim of the Commission is to force business into the EU, not to diversify risk.

43. We would like to note that it is unclear if the intention is for a portion of a firm's overall clearing of derivatives contracts stated in proposed Article 7a(2) to be at an EU CCP, regardless of whether they are currently cleared at a Tier 2 CCP or at a recognised third country CCP, or to only move a specified portion

[9] While the Impact Assessment Report mentions a few times that the application of an active account requirement only concerns new trades, the text of the draft regulation is not clear iFAANAn this respect.

of derivatives currently cleared at a Tier 2 CCP to an EU CCP. The drafting of proposed Article 7a(1) does not seem fully consistent with recitals 10 and 11.

44. While the requirement is targeted at services which are of substantial systemic importance, the requirement to clear at EU CCPs a minimum proportion of euro denominated CDS could lead to a situation where firms will have to move clearing flows from ICE Clear Credit, a Tier 1 CCP to EU CCPs to satisfy the requirements. Given that ICE Clear Europe will cease to clear CDS transactions from end-October 2023, we propose to remove these products from the list of services for which an active account is needed.

45. The requirement set out in proposed Article 7a amounts to setting a requirement to clear contracts at an EU CCP products listed under proposed Article 7a(2) that are currently cleared voluntarily. As such, it could disincentivise voluntary clearing. It also institutes new clearing requirements on products which have not gone through the required clearing obligation procedure under Article 5 of EMIR. For example, the products have not been duly assessed against the relevant criteria set out under Article 5(4). This proposal undermines the clearing obligation procedure, and leads to competing clearing obligations on different legal bases.

46. The scope of application of the active account requirement is also unclear with regards to non-financial counterparties with positions that only exceed the clearing threshold in one class of products subject to the clearing obligation, but not in others. Given the active account requirement would apply to counterparties subject to the clearing obligation, it is unclear whether non-financial counterparties in that situation would be captured by the requirement or not.

47. As futures can only be cleared at the CCP that is linked to the exchange where they are executed, the requirement to clear a proportion of STIR also means that a proportion of STIR needs to be executed at EU exchanges cleared by EU CCPs. This could lead to European brokers no longer being able to offer best execution in all cases.

Exemptions required from minimum quantitative requirements on active account

Proposed Article 7a should exempt market making and client clearing activities.

48. While the requirement to clear a proportion of transactions at EU CCPs (and ideally other Tier 1 CCPs) would disadvantage EU firms, there are two activities that are cleared at a location specifically requested by clients and therefore especially affected by the proposals. They need to be carved out from any quantitative active account requirement for EU firms to have a chance to compete in global markets:

   a. *Provision of client clearing services:* Including client clearing in the proportion of transactions that have to be cleared at EU CCPs will disadvantage European clearing members. The proposed requirements will create conflicts of interest between clearing members and their clients and prevent clearing members acting in the best interests of their clients, in particular where clients want to clear their trades at Tier 2 CCPs (because they are not directly subject to the EU clearing obligation or are themselves below the relevant clearing threshold) but the

dealer needs to clear additional trades at EU CCPs to meet its quantitative target under the new requirements. Therefore, unless client clearing services are exempted, EU clearing members would have to enact restrictions to ensure that they clear the required proportion of transactions at EU CCPs while non-EU clearing members will not face similar restrictions. The proposed requirements may also be 'counter-prudential' for clearing members, e.g., where client trades cleared on Tier 2 CCPs have exhausted a clearing member's capacity to clear on Tier 2 CCPs (and comply with the new requirements) but the clearing member wishes to clear its own trades on a Tier 2 CCP to reduce its overall exposures on that CCP.

b. *Market making:* For EU market makers, imposing a set proportion of transactions to be cleared at EU CCPs would have a material impact on their ability to compete with non-EU peers. EU market makers would have to restrict business with non-EU clients. This is because:

   i. Market makers have to clear at the CCP that their counterparty requests if the counterparty is a client and therefore have no influence over clearing location for a significant part of market making trades.
   ii. EU market makers need to be able to re-hedge themselves in the global market, often with non-EU participants, to have a chance to provide competitive quotes to their clients. Including the market making business in activity levels would make the market making businesses of EU banks uncompetitive and would potentially restrict competitive prices for end-users.
   iii. Non-EU market makers would not be subject to the same restrictions. Major non-EU clients are unlikely to accept such restrictions and will want to continue clearing on a CCP of their choice. Most major non-EU clients have multicurrency portfolios that benefit from considerable netting efficiencies on Tier 2 CCP. They will not want to give up these netting efficiencies and will therefore not deal with EU market makers.
   iv. Market makers would be restricted regarding the extent to which they could participate in the default management process at Tier 2 CCPs, and if they could participate, on how they can manage auction portfolios going forward.

49. Neither exemption will undermine the requirement to clear a proportion of transactions at EU CCPs. For both client clearing and market making, European clients that are subject to a requirement to clear a proportion of transactions at EU CCPs will clear the required number of transactions at EU CCPs in order to comply with the proposed rules. Including client clearing and market making in scope would amount to double counting where one counterparty is an EU client. Therefore, even if market making and client clearing activities were exempt, the overall required proportion of transactions by EU firms (with the exception where the market maker executes with non-EU clients or EU firms that are not subject to the requirement for an active account) firms would be cleared at EU CCPs. These exemptions would however partially reduce the competitive disadvantage of EU firms (market makers and clearing members) when dealing with non-EU counterparties.

Proposed Article 7a should exempt transactions that results from default management (both clearing members and clients) and compression/PTRR services.

50. All contracts acquired as the result of a default management process at a Tier 2 CCP should be exempt from the proportion of transactions to be cleared at EU CCPs. Otherwise, EU clearing members would no longer be able to fulfil the clearing member requirements at the Tier 2 CCP. Also, EU market makers might be restricted on the extent to which they could participate in the default management process at Tier 2 CCPs. The exemption should also apply to the risk management of the acquired portfolio going forward.

51. Transactions stemming from the default of a clearing client should also be exempt from the proportion of transactions to be cleared in the EU to allow the clearing member to manage the default in the best possible way. For instance, a clearing member might be providing access for a client to SwapClear, but not Eurex, for which the client uses a different clearing member. If this client defaults, in extremis all of the client's transactions at SwapClear need to be closed by the clearing member. Without an exemption, all transactions effected to close out the client portfolio would count towards the ratio of transactions cleared at SwapClear.

52. Finally, transactions stemming from Compression and PTRR services should also be exempt. Otherwise, it would create disincentives to the use of these services, which would reduce resilience in the derivatives markets.

Timelines for the effective reduction of exposure

The timelines set by the proposed recital 11 (and those suggested in the cost/benefit analysis report) for the effective reduction of exposure are overly ambitious and not realistic. Policy makers should set a realistic date for the effective reduction of exposure if there must be quantitative requirements for exposure reduction.

53. The proposal must recognise that opening an account at an EU CCP takes time, especially when a large proportion of firms are required to open such an account at the same time. Depending on the timelines, smaller EU firms will not immediately be able to comply with the requirement to have such account in place. From the current drafting of the proposal, it is not clear from when this requirement applies, i.e. from the day of entry into force of the Regulation or once EMIR Level 2 measures are in place. In view of this, we believe that the proposals should include adequate advance notification to impacted clearing service providers and appropriate phase-in periods.

54. The proposed recital 11 suggests that the reduction in exposures should be effective by December 2026 (5 years after ESMA's previous assessment of substantial systemic importance). The cost/benefit analysis even suggests in section 5.1 that this should be "*achieved to the largest extent possible by June 2025, when the current equivalence decision for UK CCPs expires.*" Assuming the best-case scenario that that the legislation enters into force in early 2024, and that ESMA RTS are adopted early 2025, there would be a very short window to reduce exposures.

55. We note that the impact assessment, when justifying the ongoing benefit of the proposal, is based on the assumption that market participants would voluntarily start moving positions well ahead of the

finalisation of these proposals, in anticipation of their application. This assumption is unrepresentative of the current state-of-play with regards to clearing at Tier 2 CCPs, and leads to an underestimation of the impacts of the proposed measures: the Commission's assessment only identifies minimal impacts from the proposed measures, and seems to assume that relocation could occur unrealistically fast.

Market participants need early clarity on the extension of the equivalence decision for UK CCPs beyond June 2025.

56. Lastly, market participants need early clarity on the extension of the equivalence decision for UK CCPs beyond June 2025.

Lack of cost/benefit analysis

For policymakers to have a full picture of the costs involved, especially for European banks, the Commission should provide a robust cost/benefit analysis of both the requirement to hold an active account with an EU CCP and to conduct a proportion of activity at EU CCPs.

57. We believe that a proposal that is impactful for EU market participants should be supported by a robust cost/benefit analysis. So far, there has been no sufficiently robust cost/benefit analysis on the impact of the chosen design of the active account requirement on European firms and the CMU (see above). We have severe concerns about the impact that the active account requirement as currently proposed will have on European clearing members and their clients. The fact that costs are difficult to quantify does not mean these costs will not materialise. We believe the lack of data should trigger an opposite approach: if there are no data to support bold moves as currently proposed, and if there is such a degree of uncertainty about the potential impact of the proposals, there should be all the more reason for the policy makers to move with extreme caution and in small steps.

58. The Commission's impact assessment has been limited to a small set of costs associated with the opening of a second account at an EU CCP but does not include any further analysis of costs associated with maintaining an active second account, nor with the loss of netting efficiencies.

59. The active account requirement will not only result in the opening of accounts at EU CCPs. EU clearing participants will have to, amongst other things, adapt legal documentation, internal processes, pricing, valuations, reporting processes and compliance. More cost and effort is driven by ongoing compliance with the rules. Clients are affected by this cost in particular. For asset managers, the proposal would involve opening accounts for all their clients subject to the active account requirement. This will cause considerable cost.

60. While ESMA will be required to conduct a cost/benefit analysis of the active account requirement when setting the proportion of clearing services to be conducted at EU CCPs, ESMA will be constrained by the requirements in the Level 1 text to set the proportion at a level that results in the clearing services in the specified derivative contracts at Tier 2 CCP no longer being systemic. It will therefore not be able to

choose to set the proportion at a different level, even if the cost/benefit analysis would justify this as more appropriate policy.

Transaction level information to clients

Article 7b should be amended so that there is a general disclosure requirement on clearing members to inform clients about the possibility of clearing at an EU CCP, and not a transaction-by-transaction disclosure requirement that is incompatible with the clearing workflow and market practices.

61. Most clients know what the clearing locations options are and are sophisticated enough to select the appropriate clearing location without clearing member involvement. The requirement to inform clients that a transaction ("*when one of their clients submits a contract for clearing*") can be cleared at an EU CCP suggests that this must be done on a transaction-by-transaction basis rather than through a general client disclosure. This would be incompatible with the existing clearing workflow and market practices. Prices of interest rate swaps on trading venues are quotes by clearing location. Even if a transaction is executed off venue, the client and its counterparty will already have agreed on a clearing location. Therefore, by the time a client submits a transaction for clearing, the clearing location decision will already have been taken without any involvement of the clearing member. Should the client wish to reconsider, it will have no influence or leverage over its counterparty on the agreed clearing location[10]. We would therefore urge policy makers to amend this requirement to a general disclosure to clients, not a pre-clearing information requirement within the workflow.

Disproportionate reporting requirements

The scope of the proposed reporting requirement under Article 7b(2) should be significantly narrowed to take into account the costs and operational burden for market participants, especially clients.

62. An overly complex and burdensome reporting for clearing participants, especially clients and end-users, is proposed under Article 7b(2). Whereas the purpose of this additional reporting is unclear given active account users will be required to certify compliance under the proposed Article 7a(4), the scope is extremely broad. The reporting requirement would apply to all EU entities (and non-EU entities that are subject to consolidated supervision in the EU) that use a non-EU CCP recognized under Article 25, whether or not they are subject to the active account requirement, and cover all financial and non-financial contracts, not only derivatives.

[10] Changing the clearing location could be disruptive and costly for the client and its counterparty, as it is likely that they would have to execute an offsetting transaction to the transaction already executed, and then execute a new transaction at a different CCP.

63. Many end user and other buy-side firms delegate EMIR reporting and would have to build systems to prepare the reports under proposed Article 7b(2), creating significant costs and resourcing needs. We also note that all of the information that clients would be required to report under proposed Article 7b in relation to derivatives is already provided under EMIR reporting. The scope of the proposed reporting should be significantly narrowed to take into account the costs and operational burden for market participants, especially clients.

Supervision of active accounts

64. There would be a multitude of non-financial counterparties (NFCs) and financial counterparties (FCs) subject to the proposed active account requirements. Despite the introduction of the Joint Monitoring Mechanism, EU NFC and FCs are very unlikely to be subject to the same degree of supervisory scrutiny, which could lead to an unlevel playing field regarding the supervision of the proportion of trades calculations at EU CCPs and recognised CCPs conducted by the NFCs and FCs.

65. We also note that the requirement for participants to report the outcome of the calculation set out under proposed Article 7a(3) to the competent authority of the CCP it uses raise operational issues for firms as they do not necessarily have established supervisory relationships with the competent authority of the CCPs they use. In addition, it is not clear why this information should be provided to the competent authority of the CCP to monitor the participant's compliance with the active account requirement, given that this may not be the same as the participant's home competent authority and therefore the competent authority of the CCP may lack supervisory authority over the participant.

Pillar 2 capital measures

All amendments to the CRD in relation to concentration risk to CCPs should be deleted as Pillar 2 measures are an inappropriate tool to address the risk that ESMA has identified in relation to exposures to services of substantial systemic importance. These measures harm the competitiveness of EU banks and contradict the intention of the clearing mandate.

66. The amendments to the CRD address concentration risk to exposures to CCPs generally, rather than just exposures to services of substantial systemic importance. These amendments seem to go beyond the intent of the package of measures set out under EMIR, and beyond the risks that were identified in ESMA's December 2021 assessment of UK Tier 2 CCPs.

67. The proposed amendments to Article 104(1) of the CRD enable competent authorities to impose additional own fund requirements to address concentration risk arising from exposures to CCPs. We consider that setting Pillar 2 requirements on own funds to address concentrated exposures to CCPs would disproportionately impact the competitiveness of EU banks and contradicts the intent of the clearing mandate, which lead to a concentration of exposures to CCPs by regulatory design. In addition, it is not clear how holding additional capital is the adequate mitigant for the risk that the Commission is seeking to address – especially when considering that the risk is not properly defined.

68. The proposed measures, when considered alongside the EMIR active account requirement, suggest that there could be overlapping or partially conflicting expectations from authorities. Firms would indeed have to report to the competent authority of the relevant EU CCP on their compliance with the active account requirement, but would also be subject to concentration risk levels on the prudential side which might be different given that they could involve different competent authorities. It is unclear how the methodology for addressing a perceived concentration risk to CCPs could exactly match the active account requirement without adding any additional requirement on firms.

69. Furthermore, the compliance with the active account and concentration risk requirements – depending on their calibration – could lead to the creation of considerable concentration risk for certain institutions at EU CCPs, which would seem to contravene the aim of the Commission to reduce concentration risks towards certain CCPs resulting from excessive exposures to such CCPs.

70. We note that the prudential framework for banks already addresses any potential risk to capital arising from CCPs' exposures under Chapter 6, Section 9 of the CRR (''own funds requirements for exposures to a central counterparty''). Authorities should also be reassured that there is no risk of excessive concentration at CCPs as EU firms are only allowed to clear at CCPs that authorised or recognised under EMIR and therefore meet stringent standards and are safe and sound.

71. WE also question the usefulness of the proposed mandate for the EBA to issue guidelines on the assessment of concentration risk to CCPs, when considering that concentration to CCPs largely arises as a result of the clearing mandates, and that exposures to CCPs are already capitalised under the CRR.

KEY CONCERN 2 – MAKING THE EXEMPTION FROM MARGIN REQUIREMENTS FOR SINGLE STOCK EQUITY OPTIONS AND INDEX OPTIONS PERMANENT

A recital should be introduced in EMIR 3 that recognises that in some major jurisdictions single-stock equity options and index options are not subject to equivalent margin requirements, and that to avoid market fragmentation and to ensure a global level playing field, it is appropriate to permanently exempt these contracts from the EMIR regulatory margin requirements. This will give the mandate to the ESAs to amend the Margin RTS to exclude permanently these products from the margin requirements.

72. Article 38 of the Margin RTS provides for a derogation until 4 January 2024 from the variation and initial margin obligation in respect of all non-centrally cleared OTC derivatives which are single-stock equity options and index equity options ('equity options'). This temporary derogation was introduced to avoid market fragmentation and to ensure a level playing field for EU counterparties on a global level, given many jurisdictions either have not implemented margin requirements for equity options (US[11], Singapore) or have also introduced temporary derogations (Hong Kong, Switzerland, South Korea, UK) for these contracts. The temporary derogation was intended to allow time for monitoring of regulatory

[11] In the US, equity options are not in scope of Title VII of Dodd Frank Act and are therefore not subject to the CFTC, SEC or Prudential Regulators' margin rules.

developments in other jurisdictions and was already extended twice. However, the situation has not materially changed.

73. Equity options play a significant part in the real economy and are used for multiple purposes aside from transactions between dealers, including hedging exposure to the purchase price in the context of an M&A transaction, in share buy-backs by companies and in private equity transactions as well as for stake building in preparation for takeover bids. Equity options may also be used to allow EU investors access to equity markets that are closed to direct investment from European investors (*e.g.*, emerging markets), allowing EU pension funds to diversify their portfolios. Equity options also play a key role in supporting convertible bond issuance by European corporates, but their usage in this context would no longer be viable if margin requirements were to be applied to them. Finally, certain equity option strategies allow shareholders to hedge the market risk on the shares they own and increased margin requirement could make investing in shares economically unattractive.

74. Imposing margin requirements on these instruments would increase funding costs and operational complexity and could result in smaller EU counterparties ceasing to use equity options for hedging and risk mitigation. EU market participants would face a clear competitive disadvantage when dealing with non-EU counterparties.

75. The equity options market is very small compared with the overall OTC derivatives market and most of these contracts have a short maturity. The impact of financial stability of permanently exempting these contracts from the Margin RTS is therefore not material. According to BIS data[12], equity options represented 0.5% of notional amount outstanding of all OTC derivatives in H1 2022. BIS data also shows that 64% (in notional amount outstanding) of equity linked contracts (which include both forward/swaps and options) have a maturity up to 1 year. Only 5.38% (in notional amount outstanding) of equity linked contracts have a maturity over 5 years in H1 2022, compared to 22.36% of notional amount outstanding in interest rate contracts.

76. A recital should be introduced in EMIR 3 to recognise that in some major jurisdictions single-stock equity options and index options are not subject to equivalent margin requirements and that to avoid market fragmentation and to ensure a global level playing field it is appropriate to permanently exempt these contracts from the margin requirements. This will give the mandate to the ESAs to amend the Margin RTS to exclude these products from the margin requirements.

KEY CONCERN 3 – A CONDITIONAL, LIMITED EXEMPTION FROM THE CLEARING OBLIGATION FOR POST TRADE RISK REDUCTION (PTRR) NON-PRICE FORMING RISK REDUCING TRANSACTIONS

As recommended by ESMA, and supported by the ESRB, the non-price forming risk reducing output transactions that result from PTRR should be subject to a limited and conditional exemption from the EMIR clearing obligation.

[12] BIS Statistics Explorer: Table D5.1

77. PTRR services would significantly strengthen the resilience and competitiveness of Europe's growing derivatives markets, if fully deployed. Their benefits have been clearly acknowledged by ESMA, in cooperation with the European Systemic Risk Board (ESRB), who have advocated for the creation of a coherent regulatory framework for these services. We believe that the Commission should take the opportunity of the EMIR review to establish this framework.

78. PTRR services include portfolio compression and portfolio rebalancing which enable counterparties to manage their exposure to certain types of risk in existing derivatives portfolios (such as counterparty risk, operational risk and systemic risk) without altering their fundamental market positions. To achieve this, the services often require insertion of technical, market-risk neutral, output transactions into existing netting sets.

79. A study by ESMA in November 2020[13], carried out with the ESRB, identified that PTRR services complement central clearing in helping to mitigate risks and complexity in the derivatives market, so supporting the aim of reforms put in place by the G20 after the 2008 financial crisis.

80. ESMA also stated that, in order for PTRR services to achieve their full potential, the non-price forming risk reducing output transactions that result from such exercises require a well-framed derogation from the EMIR clearing obligation. The exemption would apply only to the non-price risk reducing forming transactions that result from PTRR exercises and could therefore not be used to avoid the clearing obligation for new transactions. The UK has proposed to implement a PTRR clearing derogation in the Wholesale Market Review[14]. This raises the prospect that EU firms might be disadvantaged if they cannot participate or can only participate in such risk-reducing exercises with more complicated product types such as swaptions.

81. The need for market participants to have access to the best possible risk-reduction techniques has been reinforced by recent developments. These have highlighted the importance of tackling counterparty risk rebalancing and the liquidity stress of volatile margin demands driven by market turbulence – a risk which can be significantly dampened for market intermediaries by PTRR counterparty rebalancing.

82. A limited and targeted derogation from the clearing obligation would:

- Increase the effectiveness of PTRR rebalancing exercises that reduce counterparty risk, so flattening potential spikes in margin requirements;
- Remove barriers to a wider range of market participants using PTRR services; and
- Enable new levels of risk exposure transfer from the uncleared to the cleared market, so directly supporting the G-20 financial stability objective of increased central clearing of derivatives risks.

---

[13] ESMA Report on post-trade risk reduction services with regard to the clearing obligation: 10 November 2020 (https://www.esma.europa.eu/sites/default/files/library/esma70-156-3351_report_on_ptrr_services_with_regards_to_the_clearing_obligation_0.pdf)

[14] Wholesale_Markets_Review_Consultation_Response.pdf (publishing.service.gov.uk)

83. We strongly support the introduction of a limited and conditional exemption from the clearing obligation for the non-price forming risk reducing output transactions that result from PTRR.

KEY CONCERN 4 – INTRAGROUP TRANSACTION EXEMPTIONS

The power for the Commission to issue a delegated act identifying additional third countries whose entities may not benefit from the intragroup transaction exemption creates uncertainty and should be removed. Firms should not have to reapply for intragroup transactions exemption but should be able to rely on the existing ones (grandfathering).

Clearing and margining

84. Intragroup transactions are key to centralised management of risk by EU firms and to the ability to make investment capital available within the EU and globally in large financial, mixed and NFCs. We therefore very much welcome the removal of equivalence as a pre-condition for the availability of the intragroup transaction exemptions from clearing and margining requirements where one counterparty is in a third country. This amendment will provide certainty to the market, reduce market fragmentation and have a positive impact how the EU is perceived in terms of market openness and attractiveness.

85. We would however note that firms need certainty and predictability to manage and plan their activities, and that introducing the power to the Commission to adopt a delegated act identifying additional third countries whose entities may not benefit from the intragroup exemptions (beyond AML high risk countries and non-cooperative jurisdictions for tax purposes) will reintroduce an element of uncertainty for firms. The scope and purpose of the powers are also not clear, and we recommend removing them.

86. If the proposed Commission power is to be retained, as a minimum the criteria that the Commission intends to assess should be clarified, and there should be transparency to market participants on its potential use. Provision should be included to ensure that before any use of the power the EC must assess the potential impact to market participants of "blacklisting" a specific country and whether doing so would be proportionate to the perceived risk was intended to address. Further, it is essential that implementation periods should be provided to avoid undue market disruption.

87. We also note that firms should not have to reapply for intragroup transactions exemptions but should be able to rely on the existing ones (grandfathering). We also believe that the requirement to publicly disclose information on the intragroup transaction in Article 11(11) is providing little useful information to shareholders or creditors and adds little regulatory value. We recommend it is removed.

Credit Value Adjustment in the CRR

88. While we strongly support the proposed decoupling between EMIR and CRR on the CVA intragroup exemptions, it will be important to ensure equivalence decisions determining '*whether a third country applies prudential supervisory and regulatory requirements at least equivalent to those applied in the Union'* are adopted as soon as possible covering a wide range of jurisdictions, in particular major

jurisdictions. In that regard, we would note that currently the list of CRR equivalence decisions does not cover major jurisdictions like the UK.

89. In a recent Q&A[15] the EBA clarified that for entities to benefit from the CVA intragroup exemption, an equivalence decision to all the requirements in scope of Article 13 of EMIR should be adopted. This means firms cannot benefit from the intragroup regime for cross border trades[16] and it would be important to get clarity as soon as possible.

90. We urge policymakers to consider resolving the CVA intragroup exemption separately from the EMIR 3 proposal via the ongoing CRR 3 proposals. For instance, if this were to be resolved as part of the CRR 3 process, this would allow the new regime proposed by the Commission on the CVA intragroup exemptions to kick in earlier than if we were to wait for the end of the EMIR 3 process, and therefore could also allow the Commission to start the equivalence decisions process as soon as possible for the CVA intragroup exemption.

91. To avoid capital fragmentation and distortion across the EU Single Market, the transitional regime should be operable at the EU level, i.e. once a third country has been approved as eligible by a competent authority, this treatment should be extended across the EU. Otherwise, banks could face different treatment by entities based in different Member States when transacting with the same third-country affiliate. This would not be an optimal outcome for capital management, even on a transitional basis. We would recommend that a list of eligible third countries be maintained by the EBA.

KEY CONCERN 5 – DELETION OF ARTICLE 13: MECHANISM TO AVOID DUPLICATIVE OR CONFLICTING RULES

The deletion of Article 13 should be accompanied by an alternative mechanism for firms to avoid having to comply with duplicative or conflicting rules going forward.

92. While we are in principle supportive of streamlining legislation and would agree that the current Article 13 equivalence regime has not worked as well as was intended (in part due to the requirement for one counterparty to be 'established' in the third country), it is helpful for firms to avoid having to comply or, more importantly, requiring their clients to comply with two sets of duplicative rules.

93. EU firms currently rely on the existing Article 13 equivalence decisions with respect to risk mitigation techniques/margin requirements. The deletion of Article 13 would therefore need to be accompanied by an alternative mechanism for firms to avoid having to comply with duplicative or conflicting margin rules going forward. In addition, we also note that if the EU is no longer able to grant equivalence to a

[15] 2022_6495 Exclusion of intragroup transactions with entities in third country from the CVA risk charge | European Banking Authority (europa.eu)

[16] At consolidated level, there is no issue as intragroup transactions are not considered since netted between each other as clarified in Q&A 471. At solo level, an entity can only rely on the CVA exemption for intragroup transactions (in the case of a transaction with a counterparty located in a third country) where there is an equivalence decision under Article 13 of EMIR.

third country jurisdiction regarding risk mitigation techniques/margin requirements, some of these third country jurisdictions may reconsider granting the EU equivalence.

94. Finally, equivalence decision regarding a third country's jurisdiction reporting requirements under Article 13 could be part of a future solution which ends duplicative reporting and ushers in mutual reliance on foreign trade repositories.

KEY CONCERN 6 – TRANSPARENCY OF MARGIN MODELS FOR CLIENTS

Transparency about margin models should come from CCPs. Clearing members cannot provide more transparency than they receive from CCPs

95. While we support transparency of margin models for clients, we believe that **most of this transparency should come from CCPs, through improved implementation of the existing transparency requirement applying to CCP under current Article 38(6) and (7)**. For instance, the requirement to "*inform their clients in a clear and transparent manner of the way the margin models of the CCP work, including in stress situations, and provide them with a simulation of the margin requirements they may be subject to under different scenarios*" covers information that clearing members do not have. The information to be provided to clients according to the proposal goes far beyond the information that CCPs have to provide to clearing members under Article 38(6) and (7)(a)-(c) of EMIR.

96. BCBS, CPMI and IOSCO also identified in their report on margining practices[17] some existing gaps in CCPs' transparency towards clearing members, which underlines that clearing members might not be able to provide more transparency to client with the current level of information they get from CCPs. We also believe that the Commission should not pre-empt the global work on margin practices, which includes transparency to clients and is likely to lead to policy proposals on CCP transparency in 2023.

OTHER TECHNICAL CONCERNS

TECHNICAL CONCERN 1 – REPORTING OF INTRAGROUP TRANSACTIONS

97. Article 9 of EMIR is amended to remove the exemption from reporting requirements for transactions between counterparties within a group where at least one of the counterparties is a NFC. We understand and support the overall objective that NCAs have the necessary data to assess the build-up of risk in the system. We do not understand, however, what issue the removal of the exemption from intragroup reporting by NFCs would seek to solve. It is not clear what is the relevance of the NFC intragroup transaction is to the current energy liquidity crisis. While it is clear that regulators may wish to have more visibility of NFCs' activities to monitor for risk purposes (if a transparency deficit is identified), the focus in this context should be on the risks between groups and their external counterparties.

98. Removal of this exemption would impose significant costs on NFCs. In fact (given these costs, the practical effects of which would fall on NFCs' Treasury management teams) removal of this exemption

[17] BCBS-CPMI-IOSCO finalise analysis of margining practices during the March 2020 market turmoil (bis.org)

could actually discourage the centralised risk management that is enabled by intragroup transactions[18], with negative consequences for both risk management and investment by groups active inside and outside the EU. We also note, that, although policymakers intend to remedy liquidity issues of relevance to energy firms in the EMIR context, the NFC category includes both energy firms and other NFCs.

99. Finally, it is worth recalling that the current (limited) exemption from reporting intragroup transactions for NFCs was introduced in 2018 (with the adoption of EMIR Refit). This removed an original EMIR (2012) reporting requirement then deemed disproportionate.

TECHNICAL CONCERN 2 – INTRADAY MARGIN CALLS

100. While we stress that a CCP needs to be fully protected at all times, we welcome that a CCP should "…*consider the potential impact of its intraday margin collections and payments on the liquidity position of its participants*". As with transparency, we believe that the Commission should not pre-empt the global work on VM processes, which is likely to come out with policy proposals aimed at streamlining VM collection processes.

101. The proposal "*[a] CCP shall strive to the best of its ability not to hold intraday variation margin calls after all payments due have been received*" means that a CCP would have to call intraday VM in the currency of affected transaction so that the CCP can pay out the VM intraday to clearing participants that are due VM payments. This could cause issues to source liquidity in the right currency, especially late in the day.

102. Many CCPs address this liquidity problem by allowing intraday VM to be paid in other currencies or even securities collateral. Doing so means the CCP cannot pay out intraday VM however. We therefore believe that intraday payments require more analysis, which will be provided by the global work on VM processes.

TECHNICAL CONCERN 3 – CLEARING THRESHOLD METHODOLOGY

103. We support the amendment introduced to the methodology for the calculation of the clearing threshold (Articles 4a and 10), which moves from the current approach of whether a derivative is OTC or not to the approach of whether a derivative is cleared or not. This approach recognises the benefits of clearing and is more in line with the approach taken for the calculation of the threshold for the exchange on initial margins (Aggregate Average Notional Amount calculation (AANA)).

104. However, we do not believe that a trade should be considered cleared only if cleared by a CCP authorised or recognised by ESMA. This is not used in the AANA calculation methodology and would add significant complexity for the (by definition) small and non-systemic entities that have to calculate this threshold, without the benefit of reducing systemic risk. Depending on drafting, it might also add the complexity of

[18] The use of a centralised treasury unit and intragroup transactions has multiple benefits, including centralising expertise and specialised staff, strengthening central oversight of group-wide exposures and risks as well as well as safeguarding of hedging procedures in an auditable manner.

including futures cleared at smaller CCPs for which the Commission has not reviewed or granted equivalence.

TECHNICAL CONCERN 4 – USE OF MONEY MARKET FUNDS (MMFs) AS COLLATERAL

Broaden eligible MMFs as collateral beyond UCITS for uncleared derivatives

105. Under the Margin RTS, MMFs meeting certain conditions can be posted as eligible collateral for uncleared derivatives. One condition is that the MMF is an EU fund authorised as a UCITS. This is overly restrictive and does not accommodate the global derivatives market. Third country MMFs that invest in government securities and cash and have a similar risk and oversight framework to EU MMFs should be available as eligible collateral. We welcome that the UK authorities[19] have recognised the importance of expanding the types of MMFs eligible as collateral, and strongly encourage the ESAs to do the same.

106. A recital should be introduced in EMIR 3 that recognises the importance to allow third country MMFs subject to certain conditions as eligible collateral for uncleared trades, and we invite the ESAs to review the Margin RTS.

Allow MMFs as eligible collateral for CCPs

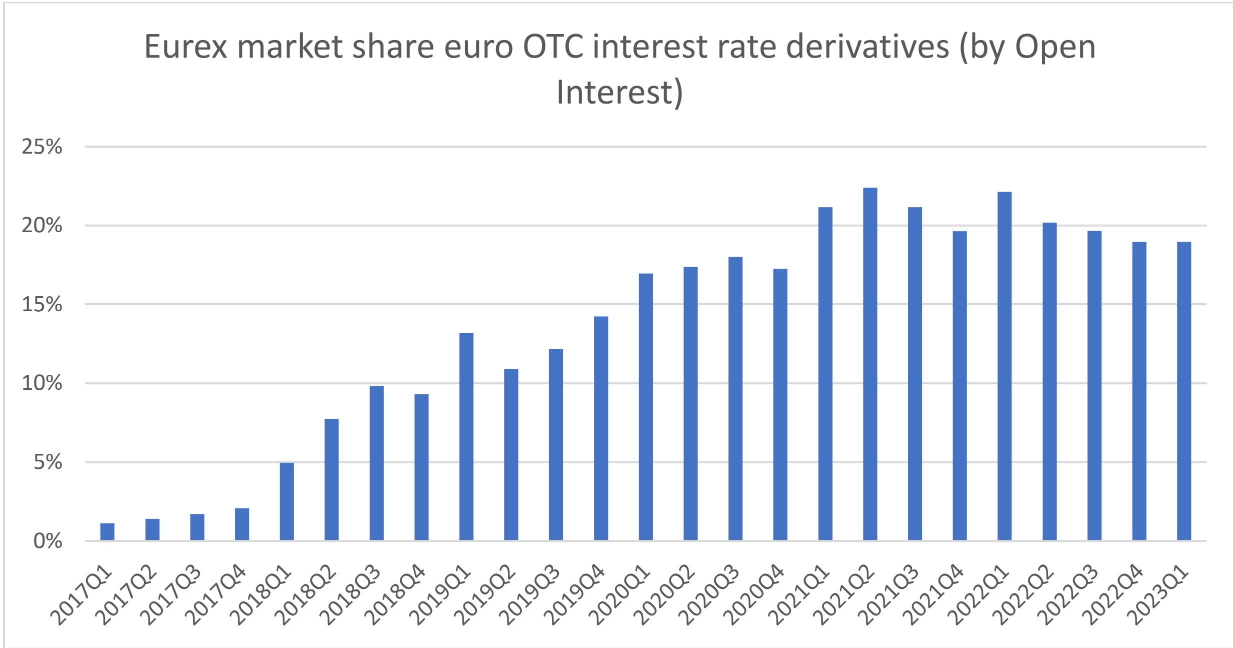
107. To support the competitiveness of EU CCPs, policymakers should review the Margin RTS to allow CCPs to accept a wider range of collateral, including MMFs, so they can meet the needs of the market, particularly buy-side firms. The use of MMFs could be supported by amending the transferability requirements.

TECHNICAL CONCERN 5 – CLIENT CONCENTRATION

108. We would support enhancing the ability of EU authorities to monitor the concentration of a client's positions across several clearing members to assess any build-up of risk in the system.

[19] PS11/22 – Margin requirements for non-centrally cleared derivatives: Amendments to BTS 2016/2251 | Bank of England

ANNEX 1- Eurex market share in Euro-denominated OTC Interest Rate Derivatives Open Interest



Source: ClarusSoft CCPView

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 79 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.