Mr Patrick PEARSON

Head of Unit Financial Markets Infrastructure

European Commission

Brussels, 20 September 2019

Dear Mr Pearson,

The European Association of Co-operative Banks (EACB), the European Banking Federation (EBF), the European Savings and Retail Banking Group (ESBG), the International Swaps and Derivatives Association (ISDA) (hereinafter 'the Associations') would like to propose, herein, a list of **third country jurisdictions that we believe should be prioritised by the European Commission for the purpose of adoption of equivalence decisions** regarding the exemption for cross-border, non-cleared derivative intragroup transactions from margin obligation rules.

The signatory associations would also like to take the opportunity to underline their belief that the European Commission's work on such equivalence decisions should be complemented by **an extension to the current derogation (expiring on 4 January 2020) for cross-border intragroup transactions under the EMIR Margin RTS**. Such an extension would allow time for the European Commission to continue its work on assessment of the appropriateness of finding these jurisdictions equivalent. It would also allow other important jurisdictions more time to develop their regulatory frameworks with respect to OTC derivative business – in particular non-cleared margin rules – such that they are more aligned with EU and BCBS-IOSCO standards. Such an extension of the derogation would also prevent market fragmentation and maintain the competitiveness of EU supervised entities engaged in derivatives business with and in these third countries.

In light of the above, this letter is structured in two sections following some preliminary remarks emphasised below:

a) Jurisdictions that have implemented (or are in the process of implementing) BCBS-IOSCO compliant margin rules, i.e. jurisdictions where the EC may view it that they see a legal basis for equivalence decisions under Margin RTS, hereinafter 'jurisdictions with margin requirements'; and

b) Jurisdictions, characterized by close links to EU supervised entities, including jurisdictions from the APAC Region, Lat-am region and EU membership candidates, which may not yet have implemented margin rules, hereinafter 'other significant third country jurisdictions. An extension of the current derogation, while sought in respect of all jurisdictions, is particularly vital to EU supervised entities' ability to do business with and in these jurisdictions.

Intragroup transactions are crucial for centralized risk management at group level by internationally active EU supervised entities

International financial groups operate through a network of subsidiaries and branches, both within the EU and across third-countries. This network allows international groups to operate in different markets, with the various entities and branches facing clients in that locality. However, in order to offer liquidity in multiple jurisdictions, international financial groups need to be able to centrally manage the risk associated with cross border trading.

In the derivatives industry, it is common for risk to be centrally managed. This allows for more efficient hedging and management of the risks that the financial group is exposed to. It also enables the use of central infrastructure, rather than having to build separate systems in each jurisdiction. This is not to say that firms do not manage risk or comply with regulatory obligations in the jurisdiction they are trading in. Rather, booking models are used which allow effective management of prudential risks to the group, and central management of derivative risk.

The management of this risk is facilitated by trades between group entities. These are not client facing trades, are not price forming, and do not alter the market or credit risk exposure. Rather, they are a block transfer of risk within the group. Client facing trades would remain subject to margin (or clearing) requirements, where those trades fall in scope.

The counterparties to the intragroup transaction are also subject to an appropriate centralized risk evaluation, measurement and control procedures. In relation to the intragroup exemption from the margin requirements, EMIR requires that the risk-management procedures of the counterparties are adequately sound, robust and consistent with the level of complexity of the derivative transaction in question.

Intragroup transactions are an essential tool in the ability of financial groups to offer derivatives business across borders. They allow central management of liquidity, which is key to enabling firms to offer the most favourable prices to their clients. The ability of EU investment firms to carry out intragroup transactions without being required to clear or margin those transactions allows EU financial markets to remain competitive. Were this not the case, the collateral cost to EU investment firms would make central risk management models prohibitively costly, and impede investment firms' ability to operate in international derivative markets.

Considering that the UK is still a EU Member State as of today, it does not formally appear in the list below. However, with regard to margin exemption of intragroup transactions, the UK is one of the jurisdictions of particular importance for EU institutions. The Associations are concerned as to whether EU supervised entities will be able to transact

under reasonable conditions with UK affiliates after 31 October. Many EU institutions have affiliates in the UK with which they trade derivatives on a daily basis. As such, it will be very important for EU institutions to benefit from an equivalence decision for the UK which has on-shored EMIR requirements and is in the process of implementing key amendments resulting from the entry into force of EMIR Refit.
We would further like to emphasise that while the jurisdictions identified below reflect the input received from a range of industry bodies and participants, EU supervised entities' business with counterparties and clients in other jurisdictions would be negatively impacted by expiry of the derogation. It is not our intention to downplay the importance of such other jurisdictions omitted from the list provided in this letter.

a) Third country jurisdictions with margin requirements

The third countries listed below[1] have implemented – or will soon have implemented – legal frameworks which should qualify for equivalence determinations in respect of intragroup transactions. Further to this consideration, the Associations have also identified business, economic or other reasons to support their request to the Commission for issuing equivalence decisions:

Australia: The Australian Prudential Regulation Authority (APRA), one of three financial markets regulators in Australia, is responsible for the adoption of IOSCO standards on margining and risk mitigation techniques in Australia. APRA has required mandatory exchange of variation and initial margin since March 2017. As a G20 jurisdiction, Australia is a key trading partner of the EU (particularly in the food market) and an important market for EU financial institutions.

Brazil: The Central Bank of Brazil and the Brazilian Securities Commission jointly oversee the implementation of G20 commitments, including the exchange of BCBS-IOSCO compliant margin requirements. Brazil's derivatives market infrastructure is one of the most developed among emerging economies. Brazil is also an important trading partner of the EU (particularly in the food market) and an important market for EU financial institutions.

Canada: The EU is Canada's second-biggest trading partner after the United States, accounting for 10 % of its trade in goods with the world in 2018 (EC data). Although it applies only provisionally, the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada further contributes to offer EU firms more and better business opportunities in such country. Under Canadian legislation, intragroup-affiliates trades are exempt from margin requirements.

Hong Kong: Trade relations between the EU and Hong Kong are strong and stable. In the last 3 years, trade in both goods and services have increased without obstacles and made Hong Kong the EU's 8th trading partner in Asia (EC data). In Hong Kong, intragroup

[1] Countries are not listed in order of priority

transactions are exempt from margin requirements for bilateral trades where the group entities are consolidated in financial accounts and subject to centralised risk management, in line with EMIR conditionality related to the intragroup exemption.

Mexico: Mexico is expected to enforce mandatory exchange of margin by the end of 2019. European and U.S. banks have large subsidiaries located in Mexico, which is a key trading economy with significant manufacturing, agricultural and commodities sectors. The recently-negotiated (in-principle) trade deal between the EU and Mexico is expected to further increase trade between the EU and Mexico.

Singapore: The EU has a significant positive balance of trade in goods and in services with Singapore. Moreover, Singapore is a major destination for European investments in Asia and represents the third largest Asian investor in the EU (after Japan and Hong Kong. EC data). The strong trade relations between the EU and Singapore are likely to benefit from the recently signed EU-Singapore trade and investment agreements. Under the Canadian legislation, intragroup-affiliates trades are exempt from margin requirements.

South Africa: South Africa is expected to enforce mandatory exchange of margin by end-2019. European banks have significant activities with and in South Africa and South Africa is an important trading partner with the EU.

South Korea: A substituted compliance framework is available under South Korean rules when foreign financial entities incorporated overseas, South Korean branches of foreign financial entities, and offshore subsidiaries of South Korean Financial Companies transact with one another, provided that the foreign regime is determined to be equivalent to South Korean Guidelines. Detailed procedures for equivalence determination will be prepared at a later date by the FSS (Financial Supervisory Services). Until detailed procedures for equivalence determination are prepared, draft or final margin regulations released by foreign regulators are deemed to be equivalent to South Korean Guidelines.

Switzerland: The Swiss and European economies are highly integrated. As a consequence, many EEA companies have subsidiaries in Switzerland and conversely many Swiss companies have affiliates in the EEA, in the corporate as well as in the financial sector. The Swiss Financial Market Infrastructure Act (FMIA), as the law governing derivative trading by Swiss incorporated entities should enable a recognition of Swiss EMIR Article 13 equivalence, as it is in fact almost identical to EMIR, having been modelled on it. This especially applies with regard to the rules governing margin obligations. Under FMIA, cross border intragroup transactions are exempt from margin obligation under similar conditions to those associated with exemptions for domestic intragroup transactions, FMIA does not pose an obstacle to intragroup risk management activity between EEA and Swiss entities.

US: Derivatives business in the US is subject to regulation by several regulators. The CFTC has broad authority over the swaps market, while the SEC oversees securities-based swaps. Firms that do their swaps business through a bank are also subject to oversight by the “prudential regulators” (i.e. Federal Reserve, FDIC and OCC) for margin and capital purposes. To date, only the CFTC regime has been found equivalent. The existence of multiple regulations in the US has the consequence of certain European institutions being subject to supervision not only by the CFTC but also by the SEC and prudential regulators. As a result, a number of European institutions are subject to the Prudential Regulators Margin rule (PR). The SEC’s margin rule is not yet effective, but should be in place in 2021.

b) Other significant third country jurisdictions

The below ***non-exhaustive*** list includes jurisdictions (in alphabetical order) which currently do not appear to have a regulatory framework which may be deemed equivalent to EU margin requirements, but which are still significant from a market, economy and political perspective, for EU supervised entities. European banking business would be negatively impacted if the derogation for intragroup transactions under Margin RTS is not extended, in respect of activities with and in these jurisdictions.

For the avoidance of doubt, the Associations are not asking the European Commission to prioritise work on equivalence determinations for these jurisdictions at this stage, nor to limit a potential extension of the derogation to these jurisdictions. We merely mention these jurisdictions because we feel it important that the existing derogation for cross-border intragroup transactions should be extended in order that EU supervised entities can continue to do business with and in these jurisdictions, allowing time for development of their regulatory frameworks, and, we hope, eventually, time for the EC to adopt equivalence determinations for them.

EU candidate countries: Albania, Bosnia-Herzegovina, Montenegro, North Macedonia and Serbia: These countries are part of the ongoing EU enlargement process and making good economic progress in this regard. We consider it important for these jurisdictions to maintain the derogation since they have the potential to become EU Member States. Absent this derogation, EU institutions would be at a competitive disadvantage compared with non-EU banking corporations who already have some form of intra-group exemption under EMIR (e.g. USA, Japan, Singapore).

Belarus: The EU is Belarus’ second largest trading partner with a share of almost a third of the country’s overall trade. An action plan has been set up for the development of capital market instruments in Belarus (including OTC derivatives) as part of the country’s 2020 Strategy for Development of the Financial Market. The strategy declares that development of the derivatives market is one of the key objectives for the formation of a robust and fully-fledged capital market in Belarus.

India: India is a significant trading partner with the EU. The EU is India’s number one trading partner and India is the EU’s 9th biggest trading partner. From 2006 to 2016, EU exports to India grew from €24.2 billion to €37.8 billion. EU investment, including those from significant non-financial EU companies, have rapidly increased in recent years. The same trend can be observed for trades in services and goods. India is the 6th largest economy and has expanded by 6.9% in 2017 and 7.4% in 2018.

Lat-am region (e.g. Argentina, Chile, Colombia): EU supervised entities engage in a significant level of financing activity with and in the Lat-am region. In the case of *Chile*, the Chilean Central Bank is taking the necessary steps to align with the international derivatives regulations, starting with the obligation to report OTC derivative transactions to a trade repository, an obligation which will enter into force in November 2020. Furthermore, the EU and Chile are working on modernization of their existing comprehensive Free Trade Agreement in 2003, as one pillar of the EU-Chile Association agreement, which is currently subject to modernizing efforts by Chile and the EU. In the case of Colombia, recent legislation has modernized derivatives business pursued there, in particular with cross-border business in mind, and it is likely to becoming an increasingly important market for EU supervised entities. It is hoped that *Argentina* – another G20 jurisdiction – will take steps to implement G20 commitments in the coming years.

Malaysia: An intragroup exemption from margin requirements has been given by the Malaysian national competent authorities. The EU is the third largest trading partner of Malaysia (after China and Singapore), accounting for 11.6% of the country's total trade. EU imports from Malaysia have gradually increased since 2006 and stand at € 25.6 billion in 2018 while EU exports have also seen a growing trend to reach €14.2 billion last year.

New Zealand: The EU is New Zealand's third largest trading partner. Similar to Australia and Brazil, the EU imports significant amounts of food stuff (and also animal and vegetable products) from New Zealand. Indeed, 73% of New Zealand exports to the EU agricultural products.

Turkey: Turkey is a significant trading partner with the EU and, as such, multiple EU banks operate subsidiaries in this jurisdiction. Recent developments in the Turkish economy mean that there is an ongoing need for EU and local business to hedge against changes in the value of TRL.

Ukraine: Strategically, the EU is Ukraine's largest trading partner accounting for 42% of total trade.

On a final note, the Associations would also like to emphasise the significance of G20 jurisdictions other than those included in the list above (e.g. China, Russia, Saudi Arabia) for which cross-border recognition would be important for the market participants. Given their G20 membership, we are hopeful that these jurisdictions will develop more advanced derivatives regulatory frameworks in due course.

We thank you for your attention and remain at your full disposal for any further information you may require.

Best regards,

Marcello Topa
Chair of the EBF Post-Trading Working Group

Hervé Guider
General Manager EACB

Chris De Noose
ESBG Managing Director

Scott O'Malia
ISDA Chief Executive Officer