ISDA Safe, Efficient Markets

International Swaps and Derivatives Association (ISDA) comments on the 'EMIR Refit' proposal

18 July 2017

ISDA is pleased to provide the following commentary on the EMIR Review proposal[1] ('EMIR Refit').

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 68 countries. These members comprise of 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.

Executive Summary

ISDA welcomes the efforts of the European Commission to review and amend EMIR. A number of the proposals put forward by the European Commission are welcome, in particular those designed to better equip EU regulators with the tools and flexibility to optimally supervise derivatives business (e.g. suspension of the clearing obligation) and to reduce costs and complexity for end users (e.g., removal of the frontloading obligation).

However we believe the framework could be further enhanced in a number of ways:

- **Proposed changes to definition of "financial counterparty"**: ISDA considers that the changes to EMIR counterparty scope proposed will have unintended (for AIFs) and/or disproportionate and damaging (for SSPEs) consequences and we urge a reconsideration of these points.

[1] COM (2017)208 final – Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivatives contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories.

- **Exemptions**:

    - ISDA considers that all transactions with EU and non-EU *central banks, debt management offices and multilateral development banks* should be exempt from obligations under EMIR. This would be consistent with the approach taken in other jurisdictions and would reflect the level of risk posed by these entities.

    - The EU is the only jurisdiction which includes within the scope of its *variation margin (VM) requirements physically settled FX swaps and forwards.* Jurisdictions such as the US, Japan and Hong Kong exclude these products. This will impact the ability of firms to hedge, broader FX market liquidity and EU banks' global competitiveness.

    - *Portfolio compression* exercises that themselves generate some new trades are the most efficient in terms of reduction of systemic and operational risk, but these are impeded by their coverage by the clearing obligation, in particular in relation to Interest Rate Swaps.

- **FRAND – the requirement for clearing services to be offered on fair, reasonable and non-discriminatory terms**: We would make the following key points:

    - ISDA members do not object in principle to offering clearing services on fair, reasonable and non-discriminatory terms. EMIR and MiFID2 already require clearing firms and their clients (if they provide clearing services) to do so on reasonable commercial terms.

    - However, further clarity is required on the meaning of "FRAND", and particularly on the interpretation of "non-discriminatory". We note that the Commission is empowered to adopt a delegated act specifying the conditions that would qualify as "FRAND", but consider that either the definition of "FRAND" should be set out in the Level 1 text, or the Level 1 text should contain an indication of the factors that the Commission will take into account.

    - FRAND requirements should not result in a mandatory clearing offering.

    - FRAND requirements should not prevent firms from offering and operating clearing services in a competitive, commercial and, most importantly, prudent risk-mitigating manner. There needs to be clarity that firms will not be obliged to provide clearing services to an existing or prospective client if the client does not meet the requirements of the firm's onboarding policy.

- **Dual sided reporting**: ISDA maintains that regulatory and industry interests would be better served by a switch to entity-based reporting, rather than adopting the amendments proposed by the European Commission. Dual-sided reporting does not preserve the quality of reported data, and also imposes unnecessary legal and financial burdens on market participants.

- **NFC clearing threshold**: We welcome the changes to the NFC+ clearing threshold. We also believe that there is a case for a consistent approach, with NFCs exceeding the threshold in one asset class also exempt from EU margin rules in asset classes in which they do not exceed the clearing threshold as well as from the clearing obligation. However we caveat our support for such an approach by drawing attention to a number of issues – including in relation to compliance, to systems, documentation and netting (in the bilateral context) and to re-pricing of contracts entered into prior to introduction of such a broader exemptive regime. In the event that such issues were addressed successfully, NFCs that are able to benefit should be permitted to continue to categorise themselves as NFC+ for all asset classes if they prefer to do so (e.g., because they have already implemented EMIR on this basis).

- **Small Financial Counterparties**: The new regime for financial counterparties with small OTC derivative positions is helpful, but we consider that it could be enhanced in a number of ways including by making the calculation optional for firms who want to and believe they have a realistic chance of qualifying for the regime and by clarification that contracts entered into prior to the clearing obligation taking effect for financial counterparties exceeding the threshold would not have to be 'frontloaded'. There is also a case for introduction in Europe of a broader de minimis regime (also covering exemptions from bilateral margin requirements) for certain small financial counterparties (as exists in the US for small credit institutions and several other G20 jurisdictions). However we again caveat this statement by drawing attention to a number of challenges associated with introduction of such a regime, regarding capital, compliance, re-pricing and systems, documentation and netting, and assert that such a regime should be optional for financial counterparties that could qualify and may require different thresholds than those proposed for the small financial counterparty regime.

- **ESMA power to suspend clearing obligation**: The mechanism for suspending the clearing obligation could be further improved, for example by providing more power and flexibility to ESMA, allowing more transparency to market participants as to when suspension is being considered, and flexibility to back-date or forward-date a suspension.

- **Clarity over scope of clearing obligation**: To avoid the accidental extension of the clearing obligation as a result of recognized CCPs subsequently clearing non-standard products variants of a product already mandated to clear, ISDA would propose amending EMIR so the only products mandated to clear are those that were offered by CCPs at the time of ESMA's clearing determination.

- **Equivalence determinations**: ISDA recommends a number of changes to the way equivalence determinations are made under EMIR, in particular in relation to mechanisms to avoid duplicative or conflicting rules, recognition of 3rd country CCPs and intragroup transactions.

- **Timing and effective dates**: We note that many of the changes in the proposal would take effect just 20 days after publication in the Official Journal, causing major practical difficulties (for example in terms of counterparty classification and reclassification), and we urge for a more realistic effective date in these instances. Other uncertainties relate to effective dates for entities that will become financial counterparties for the first time upon entry into force, but which would not benefit from the small financial regime until 6 months post entry into force, and the application of a 'frontloading' requirement to trades entered into by counterparties changing regulatory classification (because of EMIR amendments or because of changes made by MIFID 2). Consideration also needs to be given to overlaps with MIFID 2/MiFIR in respect of the trading obligation, regulatory classifications that were common to EMIR and MIFID but will now change, and whether the ability to suspend the clearing obligation for certain products should also apply for those products in the context of the trading obligation.

We would also make the following comments:

- **Pension schemes**: We welcome the proposal to extend the current exemption from clearing for pension scheme arrangements, although we note that this extension might not be in effect before the current extension expires. We propose a number of procedural means of addressing this problem.

- **Protection of client assets**: we would make the following key points:

    - We would encourage the Commission to consider the proposed scope and drafting approach so that clearing members are also protected in the event of their client's default (when such clients are providing clearing services to their clients).

    - Article 39 EMIR should cover default of clearing members and their clients. It should not cover CCP default as there is separate European legislation governing CCP resilience, recovery and resolution. Any legal consequences of CCP default should be dealt with in that legislation.

    - The drafting of Article 39 needs to be fundamentally amended to achieve an outcome that would be legally effective in all EU member states and which would not be subject to legal challenge by insolvency practitioners. ISDA members recommend that the European Commission analyse existing national member state insolvency frameworks (e.g., Part VII of the UK Companies Act 1989) and consider if a similar regime could be introduced in the EU (taking into account the fact that EU member states have different national insolvency regimes).

    - ISDA members expect the European Commission to obtain one or more independent external legal opinions confirming the legal effectiveness of the proposed drafting under EU and national insolvency laws.

- **Transparency of CCPs' Initial Margin requirements:** We welcome the European Commission's proposals, but suggest a number of further enhancements of CCP transparency herein including several metrics and provision of information on incremental default fund contributions for the margin simulation tool. Regarding transparency of the margin models we ask to include add-ons for risks not covered by the core margin model in the disclosures, rationale for assumptions made and inclusion of stress testing models. We also propose to add a requirement for CCPs to produce CCP self-assessment versus CPMI-IOSCO Principles of Financial Market Infrastructure (PFMIs). On this last point, we would like to see the additional PFMI guidance issued by CPMI-IOSCO on 5th July 2017 ("Final report on Resilience of central counterparties (CCPs): Further guidance on the PFMI") incorporated in Levels 1 and 2 of EMIR.

- **CCP Investment Policy**: We ask of the European Commission to consider whether CCPs might be permitted to invest in Money Market Funds meeting strict criteria, thus aligning EU rules with those in the US.

- **Independent directors of CCPs**: We suggest that an employee of the CCP itself or of a clearing member can become an independent director earlier than 5 years after leaving their previous employer, as we believe that it could become increasingly problematic to find suitable independent directors with appropriate current experience of CCP developments and the markets.

- **Initial margin model validation**: We are concerned that the proposal of the EU supervisory authorities for validation of internal margin models could generate uncertainty and fragmentation in application of the margin rules across the EU and US, and we do not see that such a change is justified.

- **Barriers to the use of MMFs as initial margin**: We ask the European Commission to consider whether **barriers to the use of Money Market Funds as Initial Margin** under the EU Margin RTS could be reduced, subject to strict criteria, given that they provide a secure and easier to segregate form of collateral than cash.

- **Minimum Transfer Amount (MTA):** We ask the European Commission and/or ESMA to consider how to amend Levels 1 or 2 of EMIR so that the MTA concept applies at netting set and not at legal entity level (thus making the MTA concept practically of use and less complex).

<u>Detailed comments</u>

1. Timing and effective date

Limited timing for implementation: While ISDA broadly welcomes the proposed amendments to EMIR, we note that many of the changes proposed take effect just 20 days after publication in the Official Journal. In some cases this will present firms with significant practical implementation difficulties. In particular, firms will need to conduct extensive counterparty classification review and adjustment exercises before the amending regulation comes into force, to ensure that they have captured all changes in counterparty classification (e.g., in relation to entities that will be categorised as FCs for the first time, in relation to NFCs that may now only be subject to clearing for some classes of OTC derivatives and in relation to FCs that may be categorised as FC-) and have agreed any necessary changes in documentation with all affected counterparties.

ISDA would welcome an extension of the effective date of all amendments under the amending regulation, so that the amendments become effective from a date at least 6 months after entry into force of the amending regulation. This would give firms additional time to ensure compliance and would also assist with existing timing mismatches such as those discussed below.

Mismatches in timing for certain obligations: New Article 4a EMIR which provides relief from the clearing obligation for certain financial counterparties will apply from a date 6 months after entry into force of the amending regulation. We understand that this is intended to give existing financial counterparties sufficient time to make the necessary calculations and determine whether or not they would be an FC-.

However, this does not take account of entities that will become financial counterparties for the first time under the amending regulation. As currently drafted, certain AIFs, SSPEs and CSDs will become FCs for the first time on the date of entry into force of the amending regulation. Some of these entities may also benefit from the reduced obligations on FC-s. However, since Article 4a will only apply from the date 6 months after entry into force, there will be a 6 month period when new FCs will have to comply with the full range of obligations under EMIR before they can benefit from any relief.

ISDA would welcome alignment of the effective date of relevant obligations to avoid mismatches of this sort.

Application to existing trades entered into by entities that become FCs for the first time: ISDA would welcome confirmation that existing OTC derivatives transactions will not become subject to the clearing and margin obligations where an entity that was previously categorised as an NFC becomes an FC. This could happen as a result of the change to the definition of "financial counterparty" proposed in the amending regulation, but could also happen as a result of changes to the scope of MiFID2 and other legislation or to the scope of business carried out by an entity. For example, certain commodity derivatives dealers are currently categorised as NFC as they benefit from an exemption under MiFID1, but will be required to seek authorisation under MiFID2. Similarly, an NFC may decide to seek authorisation as a result of changes in its business model. Neither EMIR nor the amending regulation provide clarity on this point.

Existing outstanding transactions entered into by an NFC should not become subject to the clearing and margin obligations upon that entity becoming categorised as an FC, as this would effectively re-introduce the concept of frontloading which the European Commission has sought to remove as part of the EMIR Refit proposal. Instead, ISDA suggests that EMIR should be amended to clarify that only new contracts entered into after an entity becomes an FC should be in scope for the clearing and margin rules.

Overlap with obligations in relation to OTC derivatives under MiFID2 / MiFIR: The proposed amendments to EMIR will also have an impact on the mandatory OTC derivatives trading obligation under MiFID2 / MiFIR. For example:

- We understand that the mandatory OTC derivatives trading obligation under MiFIR is intended to apply from 3 January 2018 for certain counterparties. ISDA would welcome phase-in of this obligation for counterparties that will be classified as FC for the first time under the amending regulation, as otherwise they will become FCs on the date of entry into force of the amending regulation and immediately become subject to the trading obligation under MiFIR.

- The proposed EMIR amending regulation includes amendments to Article 4 to reflect the scope of application of the clearing obligation where one counterparty is an FC-. If the intention is to apply the mandatory trading obligation for OTC derivatives only to entities that would qualify as an FC+, a similar amendment should be made to Article 28 MiFIR.

- ISDA welcomes the power for ESMA to suspend the clearing obligation. We would also welcome a similar power for ESMA to suspend the mandatory trading obligation under MiFIR. We question what would happen to the trading obligation were the clearing obligation to be suspended. Whilst the trading obligation is not part of EMIR, it is directly linked, as the derivatives subject to the trading obligation are a sub-set of those derivatives subject to the clearing obligation. Should the clearing obligation be suspended for a class of derivatives that are wholly or partially subject to the trading obligation, it is vital that the trading obligation is simultaneously suspended. If this is not the case, the derivatives would still be required to be traded on venue, and hence would likely be required to be cleared under the rules of the trading venue, meaning that the suspension would have little practical effect. This should be explicitly addressed as part of the EMIR Refit, as it is fundamental to the practical effectiveness of a suspension.

2. Scope – AIFs and SSPEs

a) AIFs

ISDA's position on this issue is closely aligned with the AIMA position.

The proposed changes to the definition of financial counterparty in Article 2(8) EMIR would include "an AIF as defined in Article 4(1)(a) of Directive 2011/61/EU".

Under Article 4(1)(a) of Directive 2011/61/EU, AIFs are defined as "collective investment undertakings, including investment compartments thereof, which (i) raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and (ii) do not require authorisation pursuant to Article 5 of Directive 2009/65/EC".

While we can understand the Commission's desire to achieve consistency in terms of the treatment of hedge funds under EMIR, we do not believe that the universe of entities that would move from NFC to FC status has material positions in OTC derivatives markets, given that the universe of impacted funds seems to be confined to:

a) those that benefit from the transitional provisions of Article 61 AIFMD that exempts from authorization managers of certain closed-ended EU AIFs that were already in existence on 22 July 2013; and

b) EU-domiciled AIFs with non-EU AIFMs (a structure that is atypical).

As well as questioning the reason for changing the FC definition, ISDA is also concerned that the way in which the Commission has approached this change would create significant unintended consequences. The definition of AIF under Article 4(1)(a) AIFMD is not territorially limited in any way and covers vehicles within the EU as well as vehicles outside of the EU. In theory, therefore, all hedge funds globally will in future be FCs, regardless of where they are domiciled, where their manager is domiciled and where they trade. We do not believe that it was the Commission's intention to apply EMIR in such an extraterritorial manner or to seek to regulate entities or transactions with no nexus to the EU, particularly as this would lead to requirements that would be impossible to fulfil (for example, the third-country entity would not have a National Competent Authority in the Union).

Our preference, therefore, would be to retain the existing EMIR FC definition for AIFs. This is well understood and underpins the way in which firms have implemented the rules.

However, if the Commission does wish to pursue a change to EMIR to capture AIFs established in the EU within the FC definition, we would recommend that it amend the existing definition to read:

"*... an alternative investment fund (AIF) within the meaning of Article 4(1)(a) of Directive 2011/61/EU which is either established in the Union or managed by an alternative investment fund manager (AIFM) authorised or registered under that Directive ...*"

This would mean that existing FC AIFs would remain FCs and that existing EU AIFs that are NFCs would become FCs. Under the proposed new Small Financial Counterparty designation, which creates greater proportionality in the context of the clearing obligation, and the fact that these entities are already subject to reporting obligations as NFCs, the key change for this universe of entities would be the application of margin requirements.

Separately, it is also worth highlighting that the proposed amendment set out above would rightly mean that non-EU AIFs with non-EU AIFMs that are not required to be authorized or registered under AIFMD would remain third-country entities for the purposes of EMIR rather than becoming full FCs. However, it would impact how those third-country entities are treated in the context of the clearing obligation and margin requirements when interacting with European FCs or NFC+s, meaning that they would be treated in the same manner as FCs for the purposes of Article 4(1)(a)(iv) EMIR, which is not the case today.[2] Some of the proposed changes outlined above to introduce

[2] Take, for example, a Cayman fund managed by a US manager that is a party to a derivatives transaction with a European broker that qualifies as an FC under EMIR. The test of whether EMIR applies to a transaction between an FC and a third-country entity, such as this fund, is whether the third-country entity would be subject to EMIR if it were established in the EU. Under the current framework, the result of this analysis is that the fund would be an NFC if it were established in the EU, as it would still have a manager outside of the EU and not subject to authorization under AIFMD (which is the key test in the FC definition for AIFs). Accordingly, if the fund were below the clearing threshold, it would not have to clear its trades with the European broker, whereas any fund managed by a European

greater proportionality for FCs would also benefit this universe of third-country entities.

b) Securitization Special Purpose Entities (SSPEs)

Currently, SSPEs are classified as "non-financial counterparties" ("NFCs"). Accordingly, provided that the SSPE is not part of a group which has aggregate non-hedging derivatives in excess of the clearing threshold, they are not required to comply with either the margining or clearing obligations.

The proposed amendments in the EMIR Refit would change the definition of "financial counterparty" to include a "securitisation special purpose entity as defined in Article 4(1)(66) of Regulation (EU) No 575/2013".

The effect of this amendment is that any swaps entered into by an SSPE as part of a securitisation (a “Securitisation Swap”) will become subject to the margining and clearing obligations.

ISDA's key concerns with this proposed amendment are:

- It will be difficult, if not impossible, for SSPEs to comply with the margin and clearing obligations. The majority of SSPEs do not have the systems, controls, staff or authority to exchange margin or arrange for clearing of swaps, and requiring them to comply with these obligations would fundamentally alter the economics of Securitisation Swaps.
- For exactly these reasons, Securitisation Swaps are structured so that they are fully collateralised and the counterparty is protected from the default of the SSPE (this is discussed in more detail below).
- The proposed amendment would give rise to an unlevel playing field with covered bonds.

SSPEs hedge out certain risks relating to their underlying assets or seek to alter their cashflows through OTC derivatives. The SSPE then issues securitised notes to the investors which are backed by the underlying assets. In the event the SSPE defaults, the creditors are paid in accordance with a prescribed waterfall. Typically the OTC derivative counterparty will rank ahead of the noteholders and will be paid first from the SSPE's assets. As the OTC derivative is secured by the underlying assets, there is no need to require the SSPE to comply with additional margin and clearing obligations. The OTC derivative counterparty is fully "collateralised", so there is no need to apply clearing or margin requirements to reduce counterparty risk. In addition, the SSPE is subject to a strict mandate and requirements that will not allow it to hold "spare" cash

manager would meet the FC definition and have to clear its trades with that broker, regardless of the size of its cleared book.

or assets to cover clearing and margin costs as all monies received from investors will be fully invested in the underlying assets.

Amending this proposal is critical to avoid creating significant additional hurdles to the revival of the securitisation market in Europe, which would go against a key objective of the Capital Markets Union.

We therefore respectfully ask that the EMIR proposal is adjusted to reflect these concerns.

3. Exemptions

a) Multilateral development banks (MDBs) and non-EU sovereigns (Article 1 EMIR)

ISDA supports insertion of a legally certain, full exemption of non-EU Central Banks (CBs), Debt Management Offices (DMOs) and Multilateral Development Banks (MDBs) from all EMIR requirements. This is in line with the treatment of members of the European System of Central Banks under EMIR and with the rules of the CFTC and five US prudential regulators under the US Dodd-Frank Act, which exempts transactions conducted with (US-based and non-US based) CBs, DMOs and MDBs/International Financial Institutions (IFIs) from regulatory requirements such as registration, trading, clearing and margining.

While EMIR does give the European Commission the power to adopt Delegated Acts exempting specified non-EU CBs, this mechanism is cumbersome and lengthy. To date, CBs from only eight jurisdictions have been exempted (US, Japan, Australia, Canada, Hong Kong, Mexico, Singapore, and Switzerland), against, for instance, the more than sixty jurisdictions that ISDA has considered for derivatives trading when commissioning legal opinions[3].

Applying the EMIR requirements to non-EU CBs and DMOs also does not appear to be justified given that the trading relationships with non-EU CBs and DMOs are adequately addressed under EU bank capital rules[4] which set capital requirements where collateral is not held against positions. Banks' internal risk controls also limit exposure to CBs.

If firms that are subject to EMIR are required to call margin and report transactions with non-EU CBs and DMOs, while their competitors from other jurisdictions are not, they will find themselves at a competitive disadvantage. In general, such a competitive disadvantage is not justified by the level of risk associated with trading with these counterparties.

[3] https://www2.isda.org/functional-areas/legal-and-documentation/opinions

[4] (EU Regulation on prudential and requirements for credit institutions and investment firms (CRR) and the EU Directive on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms(CRD)),

In respect of MDBs, both within and outside of the EU, there should be a complete exemption from EMIR requirements, including reporting. This reflects MDBs' unique role and position in financial markets, as well as the wider global economy.

US derivatives rules exempt non-US Central Banks from clearing and margining rules. In 2012, in a statement accompanying the CFTC End User rule[5], the CFTC explicitly exempted non-US CBs from clearing and exchange-trading requirements. This decision was taken based on 'important public policy implications' perceived by the CFTC in this context, in particular that 'if foreign governments, foreign central banks, or international financial institutions were subjected to regulation by the Commission in connection with their swap transactions, foreign regulators could treat the Federal Government, Federal Reserve Banks, or international financial institutions of which the United States is a member in a similar manner. '

The US prudential regulator and the CFTC also recently exempted 'sovereign entities' from the scope of their final non-cleared margin rules. In addition, the CFTC has exempted non-US central banks from registering as swap dealers or major swap participants.

The CFTC End User rule was published in July 2012, weeks before the publication of EMIR in the EU Official Journal. The lack of clarity over the treatment of CBs by other jurisdictions has been one of the key factors behind the decision to leave CBs' exemption at the discretion of the European Commission. Now we have more clarity on the treatment of EU CBs under the US rules, the issue should be revisited with a view to ensuring a level playing field across jurisdictions by exempting CBs from EMIR requirements.

Exposures to Non-EU CBs and DMOs are subject to EU capital requirements. In recognition of the unique status of CBs and DMOs and their lower counterparty risk status when compared to commercial market participants, the CRR allows for a tailored treatment of exposures to non-EU CBs and DMOs. Where sovereign entities meet certain credit conditions, exposures to them are allowed a more proportionate credit risk capital requirement.

Whether a credit institution or investment firm is required to calculate own funds requirements for credit valuation adjustment (CVA) risk relies on the regulatory categorization of the counterparty in EMIR. Therefore, if we consider that non-EU CBs are to be treated as third-country entities that would be non-financial counterparties (NFCs) if established in the EU, their CVA treatment would depend firstly on the ability of firms to obtain a classification from them and secondly, on whether they would be classified as NFC+ or NFC- in this circumstance.

Credit institutions and investment firms are required to hold the same amount of capital in relation to non-EU sovereign exposures for the other components of their

[5] http://www.cftc.gov/LawRegulation/FederalRegister/FinalRules/2012-17291

capital requirements, including for market risk, operational risk and (most likely, when implemented) inclusion in leverage ratio.

The current Article 1 process is lengthy and embeds uncertainty. The current EMIR Article 1 process (through which the European Commission adopts Delegated Acts specifying non-EU CBs and DMOs exempted from EMIR requirements) requires significant, lengthy work by the European Commission through the process of conducting assessments. This embeds uncertainty, and makes it impossible for credit institutions and investment firms to plan financial resource allocation.

The extent to which proportionality is embedded in these assessments is also unclear. Many non-EU jurisdictions have small, and less sophisticated OTC derivatives markets. It may be inappropriate to expect such jurisdictions to fully implement G20 commitments.

Global standards on the treatment of third-country sovereign entities. We also note that the BCBS-IOSCO report on margin requirements for non-centrally cleared derivatives[6] states that the exchange of initial margin and variation margin should cover financial firms and systemically-important non-financial firms engaging in non-centrally cleared derivatives. It explicitly states, however, that CBs, sovereigns, MDBs and the Bank for International Settlements should be excluded from this requirement.

To embed these global standards effectively they should be focused on the firms which pose the most risk, as recognized by the standards. An outright exemption for sovereign entities would be within the spirit of the BCBS-IOSCO principles.

Multilateral Development Banks. We also specifically raise the treatment of MDBs, both within the EU and outside of the EU. MDBs are unique entities within the financial system, supported by sovereign governments. Similarly to sovereign entities MDBs should be completely exempted from EMIR requirements given that they are underpinned by sovereign governments and do not pose risk to the financial system. MDBs are critical in financing growth in their member states and in taking forward a number of other G20 policy goals such as building financial and economic resilience, fostering trade and employment, protecting the climate via green financial instruments and addressing the refugee crisis.

Trades with MDBs should be exempted from the dual-sided reporting obligations, with relief granted to the MDB. This is already the case in all key derivatives jurisdictions outside the EU as can be seen from the FSB progress reports. Australia, the only key jurisdiction outside the EU still considering dual-sided reporting, mitigated this with exemptions for counterparties dealing low volumes. Single-sided reporting for MDBs would come without damage to the transparency of trades that private/commercial counterparties enter into with MDBs as they would still be reported by the MDBs'

[6] http://www.bis.org/bcbs/publ/d317.pdf

counterparties, which would respond to the needs of the supervisors of the counterparties of the MDB concerned (as already happens with trades with central banks).

Conclusion

ISDA believes that non-EU CBs and DMOs should benefit from a clear, legally certain exemption from EMIR. Were these counterparties to be left in-scope of EMIR, this would:

- Put EU firms trading with them at a competitive disadvantage (particularly in consideration of the US approach to this issue).
- Be disproportionate, given:
  - the fact that trading with them is already subject to capital requirements.
  - that these counterparties are characterized by limited counterparty risk.
  - that it is not reasonable to require developing market jurisdictions to have implemented the entirety of G20 commitments.
- Divert valuable EU officials' resources to conducting assessments associated with these Delegated Acts.

For the reasons outlined above, ISDA also believes that MDBs should benefit from a complete, clear and legally certain exemption from EMIR, including from the reporting obligations.

b) Physically settled FX forwards

Physically settled FX forwards are expected to be subject to EMIR margin requirements from 3 January 2018. This is because physically settled FX forwards will be financial instruments under MIFID 2 ((as defined in MiFID 2 and clarified in Commission Delegated Regulation (EU) 2017/565), in effect from January 2018.

Now that many countries around the world have finalized their regulations regarding margin requirements for non-centrally cleared derivatives, we want to highlight that the EU is the only jurisdiction which includes within scope of its variation margin ("VM") requirements physically settled FX swaps and forwards. These instruments are excluded from VM requirements in the United States, Japan, Canada, Singapore, Australia, Switzerland, Hong Kong and South Korea[7].

[7] In several other jurisdictions local bank supervisors have instead indicated certain expectations regarding VM for FX Contracts via adoption of, or reference to, the 2013 "BCBS Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions".

Whilst the approach taken in the EU is not inconsistent with the BCBS Margin Framework, we want to highlight that this inclusion of physically settled FX swaps and forwards in the EU Margin RTS may have certain detrimental effects on the FX market, including:

- A detrimental impact on liquidity:
    - There will be a reduction in the liquidity of physically settled FX forwards within the European market as banks not subject to the EU Margin RTS can opt not to transact these products with counterparties in scope of the EU Margin RTS due to the additional cost.
- A detrimental impact on EU banks' global competitiveness:
    - End-users not within scope of the EU Margin RTS will opt not to deal with EU banks due to the additional cost, both financial and operational, of managing VM when trading physically settled FX forwards. These entities will instead choose to trade with banks based in jurisdictions where VM for physically settled FX forwards is not included within the local uncleared margin rules. This will shut European banks out of this FX business, thus reducing the global competitiveness of European banks.

The goal of the global margin regimes of achieving global consistency and limiting regulatory arbitrage opportunities is, in our view, jeopardised by the EU's unique treatment of physically settled FX products. Furthermore, with a broad range of entity types already within scope of the EU Margin RTS, we believe the concerns we raise above will be further exacerbated by the proposal as part of the EMIR Refit to categorise all AIFs as FCs

We agree that the exchange of VM is a prudent risk management tool that limits the build-up of systemic risk, such that standards should apply for VM to be exchanged on physically settled FX forwards in a manner consistent with the BCBS Margin Framework.

However, we believe that the rules should exempt physically settled FX forwards from mandatory VM as they do for IM. Such an approach would be in line with the stated aims of the EMIR Review to allow for a proportionate application of EMIR, taking account of the different range of counterparties engaged in the use of physically settled FX forwards and allowing for different treatment depending on the level of risk being taken in a particular transaction and/or between particular counterparties.

The FX market forms the basis of the global payments system and, as such, both the number of international market participants and volume of transactions are very high. The ability of investment managers, and other end-users of physically settled FX products participating in global trade and commerce to effectively hedge their currency exposure risk is vital. Accordingly, we urge the Commission to take the points we make above into consideration, and strongly recommend that the Commission:

- Consider as part of the EMIR Refit the arguments we have made for an exclusion from the EU Margin RTS requirements in respect of VM for physically settled forwards and swaps, to achieve closer alignment between the EU approach and that in other jurisdictions while still ensuring the relevant risks are adequately addressed. We would be happy to engage in further discussion with the EU institutions and supervisory authorities regarding the nature of the exclusion and how it could be achieved.

- In the meantime, use the European Commission's power under EMIR, Article 11(15)(a) to adopt a Commission Delegated Regulation amending the EU Margin RTS (Commission Delegated Regulation (EU) 2016/2251 of 4 October 2016) to delay the application of the VM requirements to physically settled FX forwards from 3 January 2018 until the relevant European authorities have had time to consider the concerns raised above.

c) Trades resulting from portfolio compression services

Since the clearing obligations for interest rate swaps in Europe have come into force it has become increasingly difficult to manage the risks inherent in the bilateral portfolios that remain between firms, both in terms of trades that predate the clearing obligations plus also the risk that arises from new non-clearable trades. Not all legacy trades are clearable, even where they might be compatible with the offering at a CCP, because of accounting and risk management constraints on one or both parties to the trade.

Firms regularly undertake bilateral portfolio compressions which result in full terminations and some partial terminations of trades. However a compression exercise that generates some new trades would generate the greatest efficiency and reductions in systemic risks. Unfortunately, in many cases, these new trades can no longer be booked outside of a CCP, thus reducing the tools available to manage the legacy bilateral non-cleared portfolio.

MIFID 2 introduces a specific definition of Portfolio Compression and conditions applicable to such risk reduction exercises. We believe that EMIR should be revised to include the facility to allow a suitably approved and regulated compression service provider meeting the definitions and terms of MIFID 2 to generate trades that could be exempted from the clearing obligation. Such a service would, as a result, be highly constrained such that changes to the total market risk exposure of any given party should be zero, therefore ensuring no market impact from such a service. However by enabling the booking of overlay trades in legacy portfolios it would enable firms to have a simple and easy solution to manage their credit risk exposures. Without such a service, such risks could go unmanaged, or firms could resort to increasingly complex structures which (while offsetting credit risk) might also represent a more onerous approach with operational risk implications. MiFIR allows for a comparable exemption of trades resulting from Portfolio Compression exercises from the derivatives trading obligation.

4. 'Small financials regime' ('Financial counterparties subject to a clearing obligation') (Article 1(3) inserting new Article 4a in EMIR)

ISDA broadly welcomes the amendments effecting a new 'small financials' (or 'FC-') regime, under which financial counterparties whose derivatives activity falls below the EMIR Article 10 thresholds would not be required to clear.

ISDA notes that, under the European Commission's proposal:

- if a financial counterparty crosses any one of the asset class thresholds, it would be required to clear all contracts subject to the clearing obligation in other asset classes.

- financial counterparties below the thresholds (FC-) would still be subject to other EMIR requirements including margining requirements.

- all transactions are included in the calculation (unlike for the NFCs threshold, where hedging transactions do not count towards the threshold).

ISDA also observes that there is a complete exemption from Dodd Frank for small FCs that are credit institutions in the US (commercial and savings banks and credit unions and farm credit institutions with less than $10 billion in assets). Even financials that are not covered by the exemption may not have to post margin if they do not have material swaps exposure.

In fact, there is some form of de minimis exemption for financial counterparties in several other G20 jurisdictions. The table below sets out the approach taken in 5 other G20 jurisdictions.

	Thresholds in Local Currency *			**Thresholds in EUR**	
Country	**Clearing**	**Margin**	**5Y Avg Spot FX Rate**	**Clearing**	**Margin**
Canada	CAD 500	CAD 12	1,416	EUR 353	EUR 8
Australia	AUD 100	AUD 3	1,431	EUR 70	EUR 2
Singapore **	SGD 20	SGD 5	1,589	EUR 13	EUR 3
Japan	JPY 300	JPY 300	127,4	EUR 2	EUR 2

	Thresholds in Local Currency *			Thresholds in EUR	
United States ***	USD 10	USD 10	1,210	EUR 8	EUR 8

(Table provided by Chatham Financial).
Note: Currency amounts are in billions.
* unless otherwise indicated, all thresholds apply to derivatives notional
** Singapore clearing rules have not been finalized – table reflects proposed de minimis threshold.
*** in the US a 'small bank' exemption currently exists for any insured bank, credit union or farm credit institution with total assets of $10 billion or less.

ISDA believes that the FC- regime could be improved in a number of ways:

- the calculation required (in order for financial counterparties to be able to avoid having to clear) should be an optional calculation. Only firms who want to avail themselves of the 'FC-' regime would have to undertake the calculation (in order to check that they can obtain this classification). In this regard, we point out that some financial counterparties may want to clear their contracts anyway, or may believe that their derivatives activity is far in excess of the thresholds, and therefore may not want to have to undertake the calculation.

- ISDA would also welcome further clarity in the Level 1 text to the effect that contracts entered into prior to the clearing obligation taking effect for financial counterparties that have exceeded the relevant thresholds in the annual test (for the first time) would not have to be 'frontloaded' (retroactively cleared) as of effective date.

As indicated above, we feel that there is a case for exploring whether EMIR should permit some form of de minimis threshold below which financial counterparties (given the low level of counterparty and systemic risk associated) should not be required to post or receive collateral against derivatives trades,[8] i.e. they would not be required to either clear or post margin against derivatives trades if they are below the threshold in all asset classes (note that it may be appropriate for the de minimis threshold scoping small financial counterparties out of both clearing and margin requirements to be lower than that for the small financial counterparty regime as proposed by the European Commission).

[8] ISDA highlights that, although the EU non-cleared margin rules intend to allow more flexibility for clients in the types of collateral they can post to their counterparties, clients still face some difficulties and costs associated with posting non-cash collateral (especially, for pension funds, government bonds) against non-cleared trades, associated with collateral transformation or because of bank capital rules (especially the NSFR and LR) agreed at Basel level and to be implemented in the EU incentivize sell-side firms to prefer to receive cash as collateral.

We caveat this statement by pointing out that there could be a number of practical difficulties associated with introduction of such a de minimis threshold, unless managed carefully. In this regard we highlight that

- sell-side financial counterparties are continuing the current process of onboarding smaller financial counterparties for variation margin purposes.

- trades with an entity that is a financial counterparty today that becomes a financial counterparty below a de minimis threshold at a future date would possibly have to be re-priced (when trade life cycle events are triggered), a process which would be resource-intensive.

- If the de minimis threshold was to apply on a per asset class basis, this would be complex (in the bilateral margin context) from a systems, documentation and netting perspective.

- Thought would need to be given to how an eventual European approach might interact on a cross-border basis, in consideration of end user exemptions in other jurisdictions.

- If non-cleared trades with financial counterparties were not collateralized, the CVA charges associated with these trades would be higher, and this could affect pricing.

In summary, while there is a clear case for consideration of a de minimis regime for small financial counterparties, we feel that the practicalities around such a step should be carefully considered. Furthermore, such a regime should, as mentioned above, be optional for the firms involved i.e. they may opt in or out of it.

5. NFC +/- clearing threshold: amendments to test and consequences for surpassing threshold (Article 1(8) – amending Article 10 EMIR)

ISDA welcomes the changes to the clearing threshold for NFCs, in particular to limit the application of the clearing obligation for NFCs that exceed one or more asset class thresholds to only the asset class(es)for which the threshold(s) is/are exceeded. ISDA also welcomes the fact that hedging transactions still do not count towards the threshold.

We note, however, that a NFC that exceeds the clearing threshold for any class of OTC derivatives is still treated as a NFC+ for all other purposes under EMIR and, consequently, subject to stricter risk mitigation techniques and margining (i.e., bilateral collateralization) of uncleared transactions.

In particular, this requirement imposes a substantial burden on the central treasury functions of corporate groups, which would – in case one of their affiliates breach the clearing threshold in one asset class, e.g. commodities – be forced to adhere to the non-cleared margin RTS, thereby being forced to collateralize transactions in another asset class (e.g., interest rate and FX instruments). ISDA believes there is an argument supporting amendments to provide that the relief from the clearing obligation for asset classes for which no clearing threshold is breached be accompanied by relief from bilateral margin exchange.

ISDA observes that, while there is a case for broadening the exemption for NFCs to also encompass exemption from bilateral margin requirements, there are a number of practical considerations that should be made ahead of such a step. In this regard, we draw your attention to the caveats included in the previous sections on the small financial counterparty regime, many of which apply in this context.

6. Pension funds – extension of exemption from clearing (Article 1(19) and (20) – amending EMIR Articles 85 and 89)

ISDA welcomes the proposal to extend the current exemption from clearing for pension scheme arrangements to 3 years following the entry into force of the amended regulation.

However we note that the current exemption expires in August 2018, and the amended EMIR may not be adopted and in force by that date. In this event, a further delay beyond August 2018 could be effected via amendment of the Clearing Obligation RTS.

Another solution is indicated by recent developments with respect to the risk reduction package proposed in November 2016, involving changes to CRR, CRD IV, BRRD and the SRM regulation. The legislative proposal amending CRR included amendments designed to phase-in the impact on banks of the introduction of IFRS9. These proposals need to take effect from 1 January 2018 to synchronise with the effective date of the implementation of IFRS9. However, there is a real risk that the legislative proposal amending CRR will not be adopted until after this date – just because there are so many issues to address in the proposal.

To address this issue, the Council – cooperating with the European Commission – has proposed 'splitting out' the proposals on IFRS9 into a separate standalone regulation that can be fast-tracked through the legislative process - without the need for the Commission to submit a new legislative proposal to this effect. A similar approach could achieve the objective of fast-tracking the extension of the pension funds exemption.

7. Clearing – FRAND requirement (Article 1(2)(c) – amending Article 4 EMIR)

ISDA is concerned that the proposed amendment to Article 4 EMIR to require clearing members and clients providing direct or indirect clearing services to do so under "fair, reasonable and non-discriminatory commercial terms" (FRAND) may increase the burden on firms offering clearing services without increasing the availability of clearing services for clients.

We would make the following key points:

- ISDA members do not object in principle to offering clearing services on fair, reasonable and non-discriminatory terms. EMIR and MiFID2 already require clearing firms and their clients (if they provide clearing services) to do so on reasonable commercial terms.

- However, further clarity is required on the meaning of "FRAND", and particularly on the interpretation of "non-discriminatory". We note that the Commission is empowered to adopt a delegated act specifying the conditions that would qualify as "FRAND", but consider that either the definition of "FRAND" should be set out in the Level 1 text, or the Level 1 text should contain an indication of the factors that the Commission will take into account.

- FRAND requirements should not result in a mandatory clearing offering.

- FRAND requirements should not prevent firms from offering and operating clearing services in a competitive, commercial and (most importantly) prudent risk-mitigating manner. There needs to be clarity that firms will not be obliged to provide clearing services to an existing or prospective client if the client does not meet the firm's onboarding policy.

We note that the Commission is empowered to adopt a delegated act specifying the conditions under which commercial terms would be considered to be fair, reasonable and non-discriminatory. There are other references to similar requirements in other EU legislation, including the MiFIR rules requiring provision of data on a "reasonable commercial basis" and in the context of competition law[9], as well as examples under the national law of Member States[10].

However, we consider that an important distinction should be drawn between the types of services covered by these requirements and the provision of clearing services under EMIR. It is vital that the application of a FRAND principle in relation to clearing services reflects the fact that unlike these other types of service providers, firms that provide clearing services are exposed to counterparty credit risk.

As a result, there are two key considerations that firms apply when onboarding clients:

(a) Risk considerations: This primarily concerns the question of whether a potential client is a suitable entity to do business with. Article 25 RTS 6 (Commission Delegated Regulation (EU) 2017/589) requires firms to implement due diligence criteria for on-boarding firms and to review the client annually against these criteria. As a result, firms providing clearing services should not be expected or obliged to offer clearing services to any potential clients that do not satisfy these criteria, or where the potential client fails any other standard checks (including Anti-Money Laundering or Know Your Customer checks).

(b) Commercial considerations: A firm will also need to consider whether or not it is commercially viable to provide clearing services to the potential client and the basis on which any services should be provided. FRAND should be interpreted in such a

[9] We are aware that there is existing guidance in the context of competition law on interpretation of "fair, reasonable and non-discriminatory", in particular in the European Commission's guidelines on the applicability of Article 101 of the TFEU to horizontal co-operation agreements. However, these guidelines were not made in the context of mandatory conduct of business obligations for firms carrying on a particular type of business, and we understand that there is no general definition of what is considered to be "fair", "reasonable" or "non-discriminatory". As a result, we do not consider that the existing guidance given in the context of competition law is an appropriate basis for the guidance that the Commission will give in the relevant delegated act in connection with clearing services.

[10] For example, the FCA has published a Policy Statement on "Fair, reasonable and non-discriminatory access to regulated benchmarks" (PS16/4), February 2016: https://www.fca.org.uk/publication/policy/ps16-04.pdf

way that firms are able to decide whether or not to provide clearing services and to adjust their prices to reflect the risk associated with offering services to a client following a commercial assessment.

If FRAND is not interpreted in a way that gives due consideration to both risk and commercial factors, there is a risk that this requirement may be interpreted as an obligation for a firm that provides client clearing services to provide those services to all of its clients on the same basis. If firms consider that they may not be able to manage the level of risk to which they are willing to be exposed, or that they may be required to provide services to all clients on the same terms, this may disincentivise firms from providing clearing services and may ultimately reduce the availability of client clearing services in the market.

ISDA considers that these relevant factors should be set out in the Level 1 text of EMIR, rather than leaving the determination of what would be considered to be "FRAND" entirely to the Commission.

We would ask the Commission to consider the example under Article 18(5) MiFIR, which states that systematic internalisers are required to make firm quotes available to other clients. In this case, they are permitted to decide "on the basis of their commercial policy and in an objective non-discriminatory way, the clients to whom they give access to their quotes". A similar approach could be adopted in relation to the provision of clearing services.

We would also welcome early confirmation from the Commission that a firm could decide whether or not to provide clearing services to a particular client on the basis of its commercial policy, and that "fair, reasonable and non-discriminatory" in this context should be interpreted as a requirement to ensure that the firm has an objective justification for any differences in the level of fees or services that are provided to a particular client.

8. Clearing – Protection of client assets at CCPs (Article 1(11) – amending Article 39 EMIR)

ISDA welcomes the proposal to amend Article 39 EMIR to clarify the treatment of clearing members and clients in the insolvency of the CCP and of clients of clearing members in the insolvency of the clearing member. However, we would make the following key points:

- We would encourage the Commission to consider the proposed scope and drafting approach so that clearing members are also protected in the event of their client's default (when such clients are providing clearing services to their clients).
- Article 39 EMIR should cover default of clearing members and their clients. It should not cover CCP default as there is separate European legislation governing CCP resilience, recovery and resolution. Any legal consequences of CCP default should be dealt with in that legislation.
- The drafting of Article 39 needs to be fundamentally amended to achieve an outcome that would be legally effective in all EU member states and which would not be subject to legal challenge by insolvency practitioners. ISDA members recommend that the

European Commission analyse existing national member state insolvency frameworks (e.g., Part VII of the UK Companies Act 1989) and consider if a similar regime could be introduced in the EU (taking into account the fact that EU member states have different national insolvency regimes).

- ISDA members expect the European Commission to obtain one or more independent external legal opinions confirming the legal effectiveness of the proposed drafting under EU and national insolvency laws.

As discussed in ISDA's August 2015 response to the EMIR Review consultation paper, Article 4(5) of Regulation 149/2013 requires that a clearing member ensure that its procedures allow for the prompt liquidation of the assets and positions of indirect clients and the clearing member to pay all monies due to the indirect client following the default of the indirect clearer. But this so-called "leapfrog" payment may conflict with or be incompatible with the insolvency regime of the indirect clearer, or otherwise involve contentious actions, and thus be subject to challenge. For example, in the event of a shortfall in the assets available for return to indirect clients, any assessment by the clearing member as to the allocation of such shortfall amongst indirect clients is potentially complex and would invite challenge. These challenges can occur both with respect to third countries and possibly within the EU and the clearing member does not benefit from any legislative or other protections which allow it to act without risk or assess applicable risks before deciding whether to facilitate such payments.

However, we remain concerned that the proposed amendment still does not clarify either the protection available or the treatment of the relevant assets. In particular:

- The proposed amendment does not address the treatment of "leapfrog" payments;

- The proposed amendment does not address the treatment of indirect clearing (i.e., the protection available to the client of a client of a clearing member in the insolvency of the relevant client, clearing member or the CCP);

- If the assets and positions recorded in segregated accounts shall not be considered part of the insolvency estate of the CCP or the clearing member, it is unclear who the assets and positions would be considered to belong to;

- The proposed amendment does not clarify the legal mechanisms (e.g., title transfer arrangements or obtaining security interests in the assets) that would be required to give full effect to the intention of the provision.

- It is likely to be necessary to review national insolvency laws in the different Member States to determine if the proposed amendment would have the desired effect in relation to CCPs, clearing members or clients established in their jurisdiction. If the European Commission has not already obtained legal advice or an external legal opinion on the effectiveness of the proposed wording in each EU member state, ISDA members consider that it is vital for the Commission to do so before it finalises the proposed amendment. If the European Commission has already obtained a legal opinion, ISDA members would welcome publication of this legal opinion.

9. Clearing – Transparency of CCPs' Initial Margin (IM) requirements (Article 1(10) – amending Article 38 EMIR)

Under the proposal, EMIR would be amended by adding two requirements on CCPs aimed at increasing IM transparency.

The first requires the CCP to provide a margin simulation tool to clearing members:

A CCP shall provide its clearing members with a simulation tool allowing them to determine the amount, on a gross basis, of additional initial margin that the CCP may require upon the clearing of a new transaction. That tool shall only be accessible on a secured access basis and the results of the simulation shall not be binding.

The second requirement is about disclosure of information on the margin model:

A CCP shall provide its clearing members with information on the initial margin models it uses. That information shall meet all of the following conditions:

a) it clearly explains the design of the initial margin model and how it operates;

b) it clearly describes the key assumptions and limitations of the initial margin model and the circumstances under which those assumptions are no longer valid

- **Margin simulation tool**

  Many CCPs already offer margin simulation tools to their members. We welcome making this a requirement for all EU CCPs.

Such a simulation tool should be able to produce several measures:

- The IM for a given portfolio
- the additional IM required to clear additional trades, and
- IM required to clear a given trade on a standalone basis.

It would be useful, albeit not essential for the simulation, also to provide incremental default fund (DF) contributions for the above cases, which could then be used to estimate additional DF contributions for new client portfolios or changes in the house portfolio.

We would welcome more clarity on what it meant by "on a gross basis". Most CCPs calculate initial margin as one net figure across a whole portfolio, taking portfolio benefits into account if applicable. Simulation of new trades will only yield meaningful results if the net IM across the whole portfolio (including the added transaction) is part of the result (as in the second bullet point above).

We appreciate that the result of the simulation cannot be binding, as the margin models might react to new market data, or the CCP will make use of their right to ask for additional margin. The result of the simulation tool should however show the margin as the CCP models calculate it at the time with all relevant add-ons.

- **CCP Initial Margin model transparency**

  The current discussion around CCP Recovery and Resolution highlights how important resilience of CCPs is. Sufficient margin requirements are a key component of CCP resilience.

  All clearing participants, not only members, will welcome increased transparency of CCPs' models.

  Understanding margin models and being able to scrutinize them will help participants to gain comfort with the risk management models of a CCP, and increase their confidence that the default of a clearing member can be managed using IM without recourse to mutualized resources in the waterfall under most market conditions.

  The usefulness of this disclosure will depend on the level of detail and comprehensiveness of the information provided. Documentation of the margin model should also include all add-ons for risks not covered by the core margin model, for instance concentration, liquidity, seasonality, pro-cyclicality, basis or idiosyncratic risks. Overall, the documentation should allow members to fully replicate base margin and all add-ons. Additionally, the documentation should also capture rationale for assumptions made/parameters used – particularly Margin Period of Risk (MPOR) – in the margin framework.

  We suggest that the European Commission should closely align the requirements in EMIR with the CPMI/IOSCO "Final report on Resilience of central counterparties (CCPs): Further guidance on the PFMI" The report contains an extensive list of information to be disclosed and a feedback mechanism to be employed for model changes. ISDA proposes aligning EMIR with the new IOSCO guidance and adding a feedback mechanism as proposed by CPMI/IOSCO to the disclosure requirement. We also ask the European Commission to specify the required level of detail along the PFMI/IOSCO guidelines, either in Level 1 or Level 2 of EMIR.

  Given the importance of stress testing for the sizing of default funds and therefore the overall financial safeguard package of a CCP, we also ask to include – again in line with the CPMI/IOSCO guidance – stress testing frameworks in the disclosure and feedback requirements.

- **Other transparency requirements**

  While nearly all EU CCPs provide quantitative disclosure according to IOSCO standards, not all EU CCPs produce a self-assessment against the Principles of Financial Markets Infrastructures (PFMI). Such self-assessments are important tools for clearing participants to understand the whole risk management framework of a CCP and the risk they are taking by using a particular CCP.

We suggest that EMIR should require CCPs to produce such self-assessments for their clearing participants.

Further, we expect that CCPs are currently performing backtesting using a variety of schemes, including member portfolio and static portfolio backtesting, to ensure adequacy of financial resources including IM. Where CCPs are performing backtesting, ISDA recommends that the CCP should be required to provide members with information on backtesting, specifically member portfolio level back tests, hypothetical portfolio level back tests, factor level back tests and product level back tests. Where CCPs are not currently performing such backtesting, we would recommend introducing a requirement to oblige CCPs to perform the different types of backtesting.

10. Additional guidance to PFMIs by CPMI-IOSCO

As mentioned above, CPMI/IOSCO have issued a "Final report on Resilience of central counterparties (CCPs): Further guidance on the PFMI".

ISDA strongly recommends that the European Commission should use the EMIR Refit as an opportunity to integrate the additional guidance as applicable either in Level 1 or Level 2 of EMIR.

11. CCP Investment Policy (Article 47 EMIR and Commission Delegated Regulation 153/2013)

We ask the European Commission and ESMA to consider whether CCPs might be permitted to invest in money market funds meeting certain strict criteria, to align with the equivalent US rules (17 CFR 1.25).

This change would: (i) allow CCPs to exchange cash for non-cash collateral, which is easier to segregate and is more secure; (ii) remove an existing disadvantage suffered by EU CCPs, levelling the playing field and helping EU CCPs compete with US rivals; and (iii) promote the EU's UCITS and/or money market fund product. This can be achieved by adding a new section 1a to Annex II of Commission Delegated Regulation (EU) No 153/2013, specifying the required characteristics, directly and/or by reference to the permitted type of money market fund defined in the Money Market Fund Regulation (Regulation (EU) 2017/1131), such as a public debt constant net asset value MMFs .

12. Deletion of frontloading requirement (Article 1(2) – deleting Article 4(1)(b)(ii) EMIR)

ISDA welcomes the deletion of the frontloading requirement.

13. Clearing – Suspension of the clearing obligation (Article 1(6) inserting a new Article 6b EMIR)

ISDA welcomes the proposal to introduce a mechanism which allows an expedient suspension of the clearing obligation. We believe it is critical that EU regulators have the necessary tools to disapply the clearing obligation within a short period of time where it is appropriate or necessary to do so. It is important, however, to ensure that there is sufficient transparency, as well as embedded flexibility, in how the suspension process is conducted. A decision to suspend the clearing obligation could be urgent, or alternatively regulators might have more time available, meaning that any suspension process should be sufficiently adaptable to accommodate these circumstances. Furthermore, in order to ensure stable market conditions, it must be clear to market participants what a suspension means for current trading, as well as previous and future trades.

- **The rationale for the ability to suspend the clearing obligation**

  There are many possible scenarios which might warrant regulators to suspend the clearing obligation, some of which cannot be envisaged ahead of the event. For example, in the event of a deterioration in market liquidity, CCPs may find themselves clearing more risk in a contract or product than there would be market capacity to manage upon a clearing member default, or the default of another CCP. A CCP may therefore need to increase margin requirements to cover the additional risk which could force certain counterparties to liquidate their positions, further exacerbating the lack of liquidity. Counterparties would then not be able to replace the closed-out cleared contracts with uncleared contracts, as the clearing obligation would still apply in respect of those contracts, leaving hedgers exposed and potentially forcing them to curtail activity.

  Moreover, from a macro-prudential standpoint, the mandatory use of CCPs for derivative contracts that no longer have the characteristics that make them suitable for compulsory central clearing can lead to unintended consequences in terms of CCP exposures on potentially illiquid financial instruments and significant changes in margin requirements, possibly leading to pro-cyclical implications.

  An idiosyncratic stress on a key CCP could also warrant the temporary suspension of the clearing obligation. This could be due to a loss of authorization, entering into recovery or resolution proceedings[11], or operational disruption. There may also be circumstances where a CCP chooses, for business reasons, to cease to provide clearing services in a class of OTC derivatives subject to the clearing obligation, resulting in lack of connectivity or insufficient clearing capacity in the system.

[11] We note that the rules on CCP Recovery and Resolution would cover such a scenario.

- **The proposed mechanism for suspending the clearing obligation**

  ISDA welcomes the proposal to introduce a mechanism for temporarily suspending the clearing obligation. There are however a number of areas where changes could be made to make the suspension mechanism more effective:

  (a) *ESMA should have the power to suspend the clearing obligation*

  ISDA believes that in the light of ESMA's own technical expertise and the fact that circumstances may require an urgent decision on suspension of the clearing obligation, ESMA should, in addition to the proposed powers, be given the ability to directly suspend the clearing obligation itself.

  In the event that ESMA cannot be given the power to suspend the clearing obligation, it should at least be given the power to provide temporary no-action relief in circumstances it considers necessary.

  (b) *Transparency to market participants*

  It is vital that the process for suspending the clearing obligation is transparent to market participants. It is likely that a suspension of the clearing obligation would take place in an environment of market stress. There is a danger that if regulators do not act in a transparent manner, market conditions could worsen.

  ISDA acknowledge that there may be situations where it is not appropriate to disclose that ESMA have applied to the European Commission to suspend the clearing obligation. This may be the case where a CCP is considered likely to fail. However where this is not the case, an application by ESMA to suspend the clearing obligation should be made public. It is likely that if ESMA were to make such an application, market participants would be aware of the market conditions leading to the application. It therefore follows that market participants should be aware that a suspension of the clearing obligation is being considered, in order to plan ahead, and to help avoid disruption in the trading of the particular product by enabling firms to make decisions about whether it is feasible to voluntarily clear or continue trading on a non-cleared basis.

  (c) *Ability to back-date a suspension*

  There should also be flexibility for regulators to backdate the suspension. If an urgent technical issue such as an operational failure at a CCP arises, and a suspension of the clearing obligation takes days to take effect, firms should not be seen to have breached regulatory obligations where it was technologically impossible for them to meet them (i.e. where they are physically incapable of clearing through a CCP). If firms are not confident that such relief would be available with retroactive effect, ideally with temporary no-action relief, they may be forced to cease trading, bringing markets to a stand-still.

(d) *Ability to forward-date a suspension*

Equally, the mechanism should cater for a forward-dated suspension. A forward-dated suspension might be appropriate where a CCP notifies of its intention to cease providing clearing services in a class of OTC derivatives at a future date. In this scenario, the suspension mechanism could allow for the suspension of the clearing obligation to start from the date when the CCP withdraws from that relevant market. A forwarded-dated suspension would allow firms time to plan ahead and ensure there are appropriate alternative arrangements in place.

(e) *No 'frontloading' requirement*

The legislative text should state that firms are not required to subsequently 'frontload' (i.e. centrally clear) any transactions in the relevant products that were concluded during the period of suspension, once the suspension period has expired.

(f) *Recognition that not all contracts for which the clearing obligation had been suspended could immediately be margined subject to EMIR mandatory margin requirements for uncleared OTC derivatives.*

Where the clearing obligation for a class of derivatives is suspended, it should not be assumed that those contracts could be immediately margined in line with the standards set out in EMIR. This may be due to the operational complexities of margining derivatives that have not been considered before as they were subject to the clearing obligation, or more fundamental issues specific to those contracts. There should therefore be an allowance for this, either through a phased approach to margin requirements after the suspension of the clearing obligation, or by allowing forbearance.

(g) *Longer roll-over period*

As part of the mechanism for suspending the clearing obligation there should also be the ability to roll over the suspension for periods longer than 3 months, at least after the first roll over. Lack of certainty as to whether a suspension would be rolled over could cause further market disruption.

(h) *Greater flexibility in the duration of the total suspension period*

A fixed 12 month cap on the suspension period is not appropriate as it will potentially constrain the European Commission's (or ESMA's) ability to extend the suspension in situations where it is appropriate for the suspension to continue. For example, at the end of the 12 month period, the conditions which warranted the initial grant of the suspension may still be valid which would make it inappropriate to lift the suspension. This may include situations where the particular OTC derivative still does not possess the characteristics that make it suitable for central clearing.

To give the European Commission /ESMA more flexibility and time to assess the situation, ISDA proposes that the total cap period should be longer than 12 months (for example 24 months) and that in a period prior to the expiry of the initial 24 month period (e.g. Three months prior to its expiry), the European Commission /ESMA should be required to assess whether the conditions for the temporary suspension are still being met. The longer cap period would also be appropriate to take into account the recommendation in (g) for longer roll over periods.

Based on its assessment, two possible actions could be taken by the European Commission /ESMA:

- If the conditions are no longer being met, do nothing. This would result in the clearing obligation starting to take effect again at the end of the suspension period;

- Permanently suspend the clearing obligation.

The purpose of the ‘assessment period’ would be to give the European Commission /ESMA time to perform an assessment of the suspension and to be able to complete the formal steps to give effect to the decision (e.g. publication in the Official Journal). This would be important for ensuring that there is no a gap or delay in any action that the European Commission /ESMA takes (e.g. where the suspension lapses and then is later revived).

As with point (b) above, there should be transparency to the market to facilitate certainty and enable market participants to plan ahead. For example, the European Commission /ESMA should notify the public once it begins its assessment and should publicly disclose when it has reached its decision about the future state of the suspension.

Conclusion

ISDA fully supports the proposal to introduce a mechanism for temporarily suspending the clearing obligation. However, in order to avoid the risks posed by the lack of such a mechanism today, this mechanism must be fully transparent, flexible, and consider the variety of possible scenarios under which the clearing obligation might be needed to be suspended.

14. Managing and monitoring the list of products subject to the clearing obligation

ISDA recommends that the clearing obligation under EMIR should apply only to the precise OTC derivatives that were cleared by a CCP at the point in time when ESMA determined that the relevant derivatives should be subject to the clearing obligation, and not to any new contracts that become clearable after the date of ESMA's determination.

Article 5 EMIR states that where a competent authority authorizes a CCP to clear a class of OTC derivatives under Article 14 or 15, it shall immediately notify ESMA of that authorization. Within six months of receiving that notification, ESMA is required to conduct a public consultation, consult the ESRB and (where appropriate) develop and submit draft technical standards to the European Commission specifying the class of OTC derivatives that should be subject to the clearing obligation.

Article 14 sets out the process for the initial authorization of a CCP, while Article 15 sets out the process for a CCP to seek a further approval if it wishes to extend its business to additional services or activities not covered by its initial authorization.

Alternatively, ESMA may, following a public consultation and consultation with the ESRB, identify additional classes of derivatives that should be subject to the clearing obligation but for which no CCP has yet received authorization.

As a result, OTC derivatives should only become subject to the clearing obligation if ESMA has determined that it is appropriate for them to become subject to mandatory clearing following a public consultation and consultation with the ESRB.

It is possible that certain products will fulfil the criteria for clearability but cannot be cleared because at the time that the clearing obligation comes into force they include a feature (e.g. business day or maturity) that no authorized or recognized CCPs will clear. Some products could become subject to the clearing obligation at a later date simply because a CCP decides to offer clearing in those products by introducing variants within classes they are already authorized for.

An example for this would be an Asian recognized CCP that introduced a product variant with different business days tailored to Asian markets. As such swaps would be part of the mandated product class, this variant would immediately fall under the clearing mandate in the EU, even for firms who are not members of this particular CCP.

This would circumvent the regulatory process for determining products subject to clearing as well as the safeguards built into EMIR to prevent products becoming subject to clearing where this is inappropriate (e.g., where a product not liquid or standardized enough, or is only cleared by a single CCP).

It would also lead to a lack of clarity regarding the appropriate phase-in period for clearing the relevant products, and could force firms into using a CCP they would not have used otherwise, just because that particular CCP has introduced a non-standardized variant of a product mandated to clear. It would also take time for firms to apply for membership of the relevant CCP, which could take several months and during this period firms would be unable to comply with the mandatory clearing obligation for those products.

During the consultation process on the clearing obligation for G4 interest rate swaps, the question was raised as to what would happen if a new clearable feature was introduced by a CCP, resulting in new contracts within the same class being accepted for clearing, and whether the scope of the clearing obligation would become extended only by the decision of a CCP and outside the regulatory process. ESMA stated in its Final Report that it agreed that the class and the contracts within them should be determined via the RTS process rather than by the decision of a CCP, and that the selection of the mandatory classes covered only contracts that the authorized CCPs have accepted for clearing at the time of authorization.

We propose to change EMIR so that the clearing obligation applies only to exactly the OTC derivatives that were offered by a CCP when ESMA determined which OTC derivatives should become subject to a clearing obligation under Article 14 or Article 15. ESMA should be required to keep a detailed register listing which exact transaction types were offered at time of determination and do fall under the clearing obligation.

ISDA does not consider that this proposal would make it too easy to avoid clearing mandates by introducing slight variants for the following reasons:

- The non-cleared margin rules generally incentivize firms to clear products anyway.
- CCPs are incentivized to clear liquid products and therefore products with features that they do not clear are inherently likely to be illiquid.
- If members were to start trading products with a previously unclearable feature in order to circumvent the rules then if this was done in a large volume then it is likely that such a product will be deemed to have become more liquid and CCPs may start offering to clear this product (in which case the product could be mandated to clear).

ISDA would also like to propose that there should be a lead in time of approximately 6 months between notification by ESMA to the date when a product with a new feature becomes subject to mandatory clearing to enable firms to make arrangements on a new CCP if necessary to be able to clear the product.

15. Independent members of the board of a CCP

EMIR currently requires an independent member of the board of a CCP to have "*no business, family or other relationship that raises a conflict of interests regarding the CCP concerned or its controlling shareholders, its management or its clearing members, and who has had no such relationship during the five years preceding his membership of the board*".

We are concerned that this requirement for a gap of five years could mean that it becomes increasingly problematic to find suitable independent directors who have appropriate current experience with CCP developments and the markets.

ISDA recommends that the European Commission review this requirement and consider a shorter time period.

16. Non-cleared derivatives – IM model validation (Article 1(9) – amending Article 11 EMIR)

IM requirements for non-cleared derivatives have been set based on internationally-agreed, detailed principles and subject to a phase-in that is also internationally agreed.

It is not clear to ISDA why the EU supervisory authorities would want to validate models that will have been in use for at least three years in many jurisdictions that have implemented the rules by the time the revised EMIR is in effect.

For ISDA members, a key pillar of compliance with the Margin rules is the Standard Initial Margin Model (SIMM)™ project, which is focused on developing a common IM methodology that can be used by market participants globally.

The SIMM model provides an open, transparent, standard methodology that will be available to all, limiting disputes that may arise from the use of non-standardized models in an efficient way.Unlike the calculation of variation margin, which is based on day-to-day valuation changes that are often directly observable, IM calculations may indeed vary a lot and lead to different IM figures if many non-standardized models are used, even if they all are compliant with criteria set by the BCBS/ IOSCO Working Group on Margin Requirements.

This model is already in use by all in scope counterparties on phase 1 and phase 1.5 of IM implementation (firms above a 3 trillion Euro AANA threshold).

ISDA members consider that the validation requirement under EU rules, if adopted, would force the least sophisticated firms (phase 5, possibly phase 4) to obtain validation for authorities that phase 1 to 3 firms have not had to obtain. They also consider that it would not be appropriate to apply such validation to models that are already in use.

ISDA members are also concerned that this proposal could lead to inconsistent application of IM rules particularly between the European Union and the United States. This would be a significant burden not only for the industry but also for supervisory authorities across all jurisdictions where IM requirements are applicable for uncleared derivatives.

Should such an approach be adopted, the following safeguards would be vital:

- Grandfathering clause for models already in use by firms under the phases that went live before the application of the amending regulation;

- Recognition of validation granted in jurisdictions where such a requirement is in place (e.g. the US);

- For IM models that were not in place under phases that went live before the application of the EMIR revision, the validation process should focus on compliance with IM rules only and not add specific requirements that would go beyond the EU Margin RTS.

ISDA is giving further thought to this issue and will revert in more detail.

17. Non-cleared derivatives – collateral permitted as use for IM (Article 11 EMIR and Commission Delegated Regulation 2016/2251)

We ask the European Commission and ESMA to consider whether they could reduce the barriers to using money market funds as IM under EMIR: such as the concentration limits applicable to UCITS. Money market funds meeting strict criteria provide a secure and easier to segregate alternative to cash, addressing the difficulties noted in Recital 29 of the EU Margin RTS. We ask that Commission Delegated Regulation (EU) 2016/2251 be amended to allow the use of public debt constant net asset value MMFs (as defined in the incoming Money Market Fund Regulation) as IM without a concentration limit. For other defined money market funds, the current 15% concentration limit should be raised and the Euro 10 million limit should be removed: as a practical matter it can equate to a concentration limit of below 5%, making money market funds too inefficient for use as Initial Margin.

18. Non-cleared derivatives – Minimum Transfer Amount Summary (MTA) (Article 11 EMIR and Commission Delegated Regulation 2016/2251)

Article 25 of the EU Margin RTS published on 15 December 2016 addresses the Minimum Transfer Amount (MTA) for purpose of margin exchange. The MTA is a minimum amount of margin that is due before the obligations to collect or post margin are triggered. The amount can be agreed bilaterally but cannot exceed 500,000 euros. This threshold applies cumulatively to initial and variation margin.

For the calculation of the amount, Article 25 of the EU Margin RTS refers to Article 10 (for variation margin) and to Article 11 (for initial margin).

Article 10 of the EU Margin RTS specifies that "*the amount of variation margin to be collected by a counterparty shall be the aggregation of the values (…) of all contracts in the netting set (…)*."

Article 11 of the EU Margin RTS also refers to the netting set (for both the use of a consistent approach set out in Annex IV and the initial margin models referred to in EMIR).

Article 1 of the EU Margin RTS gives the following definition of the netting set: "*a set of non-centrally cleared OTC derivative contracts between two counterparties that is subject to a legally enforceable bilateral netting agreement*".

Regulators and a large part of the industry seem to understand this definition as if it had to be applied at the level of the legal entity. But this interpretation means in practice that the MTA could apply across multiple master agreements (which are legally enforceable netting agreements between two counterparties) and therefore multiple netting sets. This is particularly true in the asset management sector and forces the application of the MTA at the level of the asset management company rather than at the fund level. This makes the MTA provision ineffective for a significant part of the industry.

The EMIR Refit gives an opportunity to clarify how the MTA applies through a clear definition of the netting set.

Possible solutions include:

a) **Clarification/amendment in the Level 1 Regulation to the effect that the MTA applies at the netting set on the basis of a netting set definition that clearly takes into account that there can be multiple netting sets (i.e. multiple master agreements) within the same legal entity**. It would particularly make a distinction between the asset management sector and other categories of counterparties. That kind of distinction is not unusual in EU legislation (for instance, the MiFID 2 commodity derivatives position limits regime recognizes the specifics of the relationship between firms in the asset management sector to limit the application of the aggregation principle).

Though it is not directly linked to the minimum transfer amount provision, we note that recital 13 of the EU Margin RTS states that "*While the thresholds should always be calculated at group level, investment funds should be treated as a special case as they can be managed by a single investment manager and captured as a single group. However, where the funds are distinct pools of assets and they are not collateralised, guaranteed or supported by other investment funds or the investment manager itself, they are relatively risk remote in relation to the rest of the group. Such investment funds should therefore be treated as separate entities when calculating the thresholds, in line with the BCBS-IOSCO framework.*"

This wording acknowledges the specific situation of investment funds which would deserve to be treated as single entities.

While such a change would require a significant repapering exercise for existing CSAs, such an exercise would be undertaken on a limited amount of contracts, and it would not have to be initiated for some years.

ISDA acknowledges that the EMIR regulation does not itself deal with the MTA provision as it is a feature of the margin requirement for which a mandate was given to ESMA to elaborate the applicable regime.

b) **amendments to the EU Margin RTS** and notably to Article 1 (definition of the netting set) to clarify that the netting set can be calculated below the legal entity level in certain situations where multiple nettings sets exist within the entity. The industry will design and propose an appropriate definition of netting set that would embrace this situation.

19. Amendments to the reporting regime (Article 1(7) – amending Article 9 EMIR)

ISDA welcomes the efforts by the European Commission to alleviate burdens on end users associated with reporting.

Nevertheless, ISDA maintains that a move to an entity-based reporting (away from double-sided reporting) system would not only ease burdens on all market participants, but could also enhance the integrity of market participants' reports. Such a move would be preferable to the approach taken by the European Commission in the proposal.

In this regard, we make the following points:

- ***Dual-sided reporting does not preserve the quality of reported data***

  Although dual-sided reporting has been viewed by regulators as reinforcing the integrity of trade data, we believe that it actually detracts from the ability of regulators to make use of reporting data. Analysis of transaction reporting (also dual-sided) failures, for example, suggests discrepancies are often attributable to divergent reporting of data in fields that are not material to the transaction but required under regulation (e.g. notional currency in ISO 4217 value (CNY) versus use of a non-ISO value (CNH)). Additionally, this new obligation (dual-sided reporting for financial counterparties' trades with small non-financial counterparties) will not improve the capacity of regulators to detect any eventual data anomalies. In fact, the reporting counterparty will simply be reporting the exact same trade twice. This will give the appearance of a high matching rate but will not in itself increase data quality. It will merely duplicate the number of trade reports that regulators receive with no additional value.

  Although EMIR confirmation rates are well above 90% in all derivatives asset classes, EMIR reporting demonstrates poor pairing rates (c. 60%). This suggests that European regulators' preference for a double-sided reporting approach as a buttress to data quality is misplaced. Regulators could better rely on the effective application of the confirmation and portfolio reconciliation rules to ensure that market participants have reconciled and agreed key transactional data points that are separately reported to trade repositories, hence ensuring data quality.

- ***Dual-sided reporting imposes unnecessary legal and financial burdens on market participants***

  These burdens are such that delegated reporting – intended as a means to alleviate cost and burdens for end users – may actually drive end users to build self-reporting infrastructure:

  - Where end users (apart from the NFC-s who benefit from mandatory delegation) delegate reporting to counterparties or third parties, they retain legal responsibility for accurate and complete reporting. They retain legal liability, with no recourse.

  - Both mandatory delegation (for NFC-s) and ordinary delegation (as permitted under EMIR 1) for end users comes at a cost to end users, and the requirement to agree, maintain and reconcile different delegated reporting agreements across multiple dealers and/or third parties. In the case of mandatory delegation now permissible under the proposed EMIR 'Refit', the new liability imposed on financial counterparties is likely, ultimately, to be costed into trading with and reporting for NFC-s. Furthermore, these multiple agreements require reconciliation, creating a challenging operational environment (as well as data quality issues). An ISDA survey of end users conducted in 2016 estimates the cost to end users of the reporting framework at between €2.4 and €4.6 billion. As such, we believe that a shift to entity-based reporting would be aligned with the European Commission's stated wish to reduce the burden of duplicative reporting regimes (as mentioned in the Call for Evidence).

- ***Dual-sided reporting imposes liquidity constraints on firms***

  Under mandatory or ordinary delegated reporting, end users are faced with having to trade only with dealers that offer delegated reporting *for a given product set*. This limits end users' ability to source the best possible price.

  On the changes proposed by the European Commission, we make the following further comments:

  - We welcome the removal of requirements to report intragroup transactions where one counterparty is an NFC (although the 'equivalence' pre-condition regarding intragroup trades involving a group entity in a non-EU jurisdiction remains a significant hindrance).

  - The part-removal of the backloading requirements is helpful (backloading must continue for contracts entered into before 12 February 2014).

  - As mentioned above, the mandatory delegation regime creates a number of new legal issues for financial counterparties. These operational and legal uncertainties will add complexity and expense to reporting requirements, if not addressed. For example, it is very important that financial counterparties should not be legally responsible for counterparty data provided to them by their counterparties (e.g. in the case of the reporting field regarding hedging transactions in RTS 148/2013, the financial counterparty would not be able to verify whether the non-financial trade was or was not for hedging purposes).

  - There is still some uncertainty under the proposed amended text as regards the more general issue of who reports when an EU entity trades with a non-EU entity.

We continue to believe that it would be possible to design a workable reporting hierarchy by reference to:

- the election made between counterparties regarding the reporting party;

- whether a firm is a clearing member;

- the sectoral regulation applicable to the firm; and

- the size of the firm's OTC derivatives book.

This would greatly reduce the cost burden associated with EMIR reporting and also lead to an improvement in the data held by trade repositories.

In this regard, ISDA has previously proposed the following wording for purpose of amendment of EMIR:

Article 9

1. **Financial counterparties, non-financial counterparties that meet the conditions referred to in Article 10(1)(b) EMIR and CCPs** shall ensure that the details of any derivative contract they have concluded and of any modification or termination of the contract are reported to a trade repository registered in accordance with Article 55 or recognised in accordance with Article 77. The details shall be reported no later than the working day following the conclusion, modification or termination of the contract.

   There shall only be one reporting party in relation to a derivative contract. The reporting counterparty shall be: a) If a CCP authorised in accordance with Article 14 is a counterparty, that CCP; b) If only one counterparty is an FC or NFC, the FC or NFC; c) If one counterparty is an FC, that FC; d) If both counterparties are FCs, or if both counterparties are NFCs, the reporting counterparty shall be specified in technical standards.

We would also propose that Level 2 measures should further define the reporting hierarchy for transactions between FCs.

ISDA will revert with more detail on EMIR Reporting issues in due course.

20. Equivalence determinations

We would like to take this opportunity to raise again some important points regarding the use of equivalence determinations under EMIR.

- **Article 13 Equivalence – mechanism to avoid duplicative or conflicting rules**. The absence of equivalence decisions, particularly for the purposes of clearing and margin requirements, could put the international operations of many firms at a competitive disadvantage by requiring, for example, that margin be posted and collected multiple times. This outcome would harm not only banks but their clients too, many of which are major European corporates that make significant contributions to outbound and inbound trade and investment flows from EU to non-EU markets.

  ISDA also has some concerns about the practical application of Article 13 Equivalence determinations, as it is not fully clear how Article 13 would apply in practice to trades with counterparties established in, or subject to the rules of, an equivalent jurisdiction. In particular, ISDA considers that:

  - Article 13 should be amended to clarify that it applies where counterparties are subject to the rules of an equivalent jurisdiction (for example, because they operate through a branch in that jurisdiction) and not just where they are established in a particular jurisdiction;

- o when EU counterparties trade with counterparties established in, or subject to the rules of, an equivalent third country jurisdiction, the parties should be permitted to mutually agree which set of equivalent rules would apply to a particular trade between them;

- o Article 13(3) should allow for separate equivalence determinations to be adopted regarding the obligations contained in Articles 4, 9, 10 and 11 EMIR, instead of a single all-encompassing equivalence determination, and that any assessment of equivalence for the purpose of Article 13 EMIR should follow an outcomes-based approach; and

- o while the European Commission should seek to engage with third country regulators, it should not be a requirement for third countries to have to apply for an equivalence determination.

- **Article 25 Equivalence – recognition of third country CCPs**. We welcome the proposal in the Amending Regulation to extend the transitional period under the Capital Requirements Regulation (CRR) permitting firms to continue to apply qualifying CCP (QCCP) capital treatment to CCPs not recognised by ESMA. However, we are concerned that this is only a short term solution to what is potentially a long term problem. We set out in our August 2015 response to the EMIR Review consultation some of the difficulties that are caused by the link between QCCP status under CRR and the recognition of non-EU CCPs under EMIR, proposing, at that time, each of the following:

    - o Decoupling the link between CCP recognition under EMIR and QCCP treatment under CRR, so that non-EU CCPs that do not apply for EMIR recognition (e.g., because they are not providing clearing services to EU clearing members) can still qualify as QCCPs, which would allow non-EU affiliates or subsidiaries of EU firms to continue clearing at such non-EU CCPs without incurring punitive capital requirements on their exposures.

    - o Permitting EU firms to be clearing members of unrecognised CCPs provided that the CCP complies with the CPMI-IOSCO PFMIs (with the caveat that the clearing member will not be allowed to clear house business subject to the EMIR clearing obligation through such an unrecognised CCP).

    - o Clarifying that not all OTC derivatives cleared by non-EU recognised CCPs will potentially become subject to the mandatory clearing obligation. Rather than require ESMA to consider all OTC derivatives cleared by a non-EU recognised CCP, there should be an initial threshold applied to give market participants more certainty about which contracts may potentially become subject to mandatory clearing, and to reduce the burden on ESMA.

- Allowing a third country regime to be considered equivalent in respect of all CCPs established in that third country jurisdiction or just a particular class of CCP or CCP service, activity or class of financial instruments. This approach would reflect the approach taken in the legislative proposal on CCP supervision[12].

We recognize that, in the context of Brexit and mindful of the European Commission's proposal published on 13th June 2017, there is a heightened level of sensitivity around this issue and particular as it relates to the appropriate EU oversight of third-country financial market infrastructure which may be systemic to the EU financial system. The recommendations above were drafted in consideration of a different set of circumstances, and in particular in consideration of the ability of non-EU subsidiaries to act as clearing members in Asia and South America on a risk- and capital-efficient basis, and where systemic implications may be more remote. We intend to further consider these issues and elaborate our recommendations in our position and advocacy on the EMIR 2.0 proposal.

- **Article 3 Intragroup transactions**. Where a non-EU entity enters into an OTC derivative with an EU group entity, the intragroup exemption from margin or clearing is currently only available where the jurisdiction of the non-EU entity has been determined to be equivalent under Article 13(2) EMIR (although the EU Margin RTS and the clearing RTS provide for delayed implementation of the requirement for an equivalence determination).

  We welcome the proposal in the amending regulation to introduce an intragroup exemption from the reporting obligation where one counterparty is an NFC. However, we remain concerned by the fact that the intragroup exemption is only available where an equivalence determination has been made.

  We would make the following comments:

  - In order to benefit from the intragroup exemption, entities already have to meet strict requirements regarding consolidation and appropriate risk evaluation, measurement and control (except in limited circumstances). It is not clear why entities seeking to rely on the intragroup exemption also need to be established either in the EU or in an equivalent non-EU jurisdiction. In any event, if the European Commission adopts an implementing act on equivalence under Article 13(2), the EU counterparty will be able to rely on the deemed compliance provisions under Article 13(2) and would not need to apply for the intragroup exemption. As a result, the requirement for an implementing act on equivalence appears to be redundant and we would propose that the references in Article 3 to implementing acts under Article 13(2) be deleted.

  - In the event that the European Commission does not amend Article 3 as proposed above, we would propose some amendments to clarify the scope of Article 3.

[12] http://ec.europa.eu/finance/docs/law/170613-emir-proposal_en.pdf

We understand that it is likely that decisions on equivalence under Article 13(2) will be made on a rule-by-rule basis, so a jurisdiction may be found equivalent for the purposes of the margin rules but may not be found equivalent for the purposes of the clearing rules. Therefore, Article 3 should make clear that the intragroup transaction exemption is available where the relevant non-EU jurisdiction has been found equivalent for the rule-set in question.

- Article 3(2)(a)(i) should make clear that it applies where "the other counterparty is established in the Union or if it is established in a third country ..."

- Article 3(2)(a)(ii) should make clear that it applies where the other counterparty is a financial counterparty, a third country entity that would be a financial counterparty if it were established in the EU, a financial holding company ..."

- Article 3(2)(d) should make clear that it applies to "an OTC derivative contract entered into with a non-financial counterparty (or a third country entity that would be a non-financial counterparty if it were established in the EU) which is part of ..."

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