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# EBF POSITION ON THE EMIR REFIT PROPOSAL

## General Remarks

The EBF welcomes the proposal to revise the EMIR Regulation, and to reduce the burden on smaller financial counterparties. In particular, we welcome the proposals to delete the frontloading and backloading requirements, and the possibility to temporarily suspend the clearing obligation in certain situations.

Our members are also keen to ensure coherence between EMIR and MiFIR. If a counterparty is to be exempted from the clearing obligation in EMIR it should also be exempted from the obligation to trade the instrument on a regulated market, MTF or OTF (MiFIR Article 28).

### 1. Reclassification of Securitisation Special Purpose Entities as financial counterparties under EMIR

Under the current European Market Infrastructure Regulation (EMIR), EU established securitisation SPVs do not fall under the definition of financial counterparties and they are designated as non-financial counterparties (NFCs). The Commission's proposal to reclassify securitisation SPV's, under EMIR, as Financial Counterparties from their current status as Non-Financial Counterparty's (NFC's) will subject these deals to the clearing and margining rules and will result in severe problems for existing deals. It remains unclear where the collateral for this provision would come from, and if there is no provision for this payment in the transaction waterfall then it will have to be diverted from other uses potentially coming from note interest and principal repayments.

The original EMIR proposals seemed to accept that securitisation SPV's were created solely for the purposes of a single deal and are very different to other corporate entities and therefore this justified the differentiated treatment. Unlike a corporate, a securitisation SPV has no discretion on determining any cash movements. Most securitisation SPV's can currently avail of the hedging exemption where derivative contract that is entered into by an NFC for "hedging" purposes, that is, purposes which are "objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity of the NFC", does not count towards the relevant clearing threshold.

Additionally, we believe that imposing such intensive obligations (clearing and margin requirements) for SSPEs is unnecessary as SSPEs already contain risk mitigants and are protected from counterparty risks.

First, SSPEs contain "risk mitigation" features to protect a counterparty entering into an OTC derivative contract with them. In fact, the securitised exposures (assets of the SSPEs) are by construction constituting the collateral of the OTC derivative contract. The rights of a counterparty entering into an OTC derivative contract with the SSPEs are entirely secured by the securitised exposures as these rights rank senior or *pari passu* with those of the most senior noteholders. As such, this counterparty will assume higher recovery rates upon the SSPE's default even though they have uncollateralised positions.

Second, SSPEs are already protected from counterparty risks. The credit rating agencies already require a counterparty entering into an OTC derivative contract with SSPEs to post collateral if its credit rating drops below certain specified triggers – as part of broader risk mitigation measures that are designed to protect the SSPEs from counterparty risk. Such collateral is held in a separate account, legally ring-fenced from the securitisation (i.e. not available to the securitisation creditors). As such, this counterparty is protected against collateral being co-mingled with SSPE's other assets.

Another aspect that seems to be absent from the debate surrounding the implementation of this new proposal is how it feeds into the aim of the Securitisation Regulation. The European Commission has stated that the purpose of developing the securitisation framework is to:

1. Restarting markets on a more sustainable basis, so that simple, transparent and standardised securitisation can act as an effective funding channel to the economy;

2. Allowing for efficient and effective risk transfers to a broad set of institutional investors as well as banks;

3. Allowing securitisation to function as an effective funding mechanism for some nonbanks as well as banks;

4. Protecting investors and managing systemic risk by avoiding a resurgence of the flawed "originate to distribute" models.

It is hard to see how the new EMIR proposals support the aims of the Securitisation Regulation, the new proposals are likely to result in lower credit ratings for investors as cash is diverted from notes and principal payments to fund margin payments.

## 2. Margin requirements for physically-settled FX forwards

Physically-settled Foreign Exchange (FX) Forwards benefit from a temporary exemption of variation margin requirements under EMIR. This exemption is only applicable until 03 January 2018, the day of the entry into application of the recast of Markets in Financial Instruments Directive (MiFID 2).

The variation margin requirement for physically settled or deliverable FX Forwards was taken on the basis of BCBS IOSCO principles published in September 2013. Whereas this requirement has not been applied neither in Asia nor in the United States, it has been adopted in Europe through EMIR, but under the aforementioned temporary exemption.

For obvious competition reasons, the European banking industry is highly concerned as the end of the exemption period is getting closer. The banks that we represent fear that their clients will, starting from January 2018, move their trades out of Europe towards non-European financial counterparts which are not submitted to variation margin requirements when entering into such transactions. We believe that a purely European requirement would be counterproductive and go against the principles of the Capital Market Union by creating entry barriers to European financial markets. Besides this, margin requirements can only be considered an effective tool to ensure financial stability when applicable to all market participants in any jurisdiction of the world.

As a consequence, it seems to us necessary, for fair level playing field reasons to:

- (i) extend the temporary exemption from 03 January 2018 until the entry into application of the contemplated EMIR Refit (based on the Commission's proposal published on 04 May 2017); thus, we urge the European Commission to consider a fast track procedure in order to extend the temporary exemption.

- (ii) complement the temporary exemption with a permanent exemption of variation margins for physically settled FX Forwards in the future text of EMIR Refit.

### 3. Mandatory delegation of reporting: Financial counterparties (FCs) reporting on behalf of small non-financial counterparties (NFCs-)

With regard to trade reporting, we welcome the exemption of small non-financial counterparties (NFCs-) from the transaction reporting obligation given the operational complexity this is generating for these entities. However, requiring financial counterparties (FCs) to report both sides of their transactions with NFCs- would result in additional burden for FCs without improving the quality of the reported data. On these grounds, we recommend moving from a 'dual-sided' mandatory delegation regime to a single-sided reporting for FCs' transactions with NFCs-.

Under a 'dual-sided' mandatory delegation regime, regulators would receive twice the same information from one of the counterparties (i.e. the FC) thereby not increasing the quality of the reported data. The end result in terms of data reporting would be the exact same as single-sided reporting but with added legal and operational burdens for FCs. Indeed, FCs would need to undergo significant IT investments (that would go on top of ongoing IT investments necessary to perform existing reporting regimes) while bearing the burden of being legally responsible for the data transmitted to them by NFCs-. At the same time, NFCs- will have to provide FCs with the details necessary to perform the reporting on behalf and – possibly - to check on the accuracy of the data reported on their behalf. In this sense, a burden deriving from the reporting obligation would still exist – in practice – also for FCs. It seems therefore that this proposal runs counter to the Commission's intention to reduce the excessive burden that may arise due to duplicative reporting regimes, as stated in the Call for Evidence.[1]

For all these reasons, a shift from 'dual-sided' mandatory delegation regime to single-sided reporting should be considered. This would reduce burdens deriving from reporting obligation for both NFCs- and FCs.

### 4. Non-discriminatory access to clearing

Whilst we support the general requirement to observe fair, reasonable and non-discriminatory commercial terms in the provision of clearing services, there is a need to clarify this point in view of the risk associated with client clearing and indirect clearing.

[1] "There may be areas of EU legislation that impose burdens not commensurate with the intended policy objectives, for example, without proportionate associated material benefits in terms of making the system safer, or where they create unintended consequences. Burdens may also arise due to excessive complexity or duplicative reporting requirements." (EC Call for Evidence, 2006)

Institutions must be free to decide independently on the terms under which they will provide these services.

The Commission will adopt a delegated act in accordance with Article 82 to specify "the conditions under which commercial terms referred to in the first subparagraph are considered to be fair, reasonable and non-discriminatory". It should therefore be expressly clarified in this delegated act that clearing members are not under any obligation to take on a customer as a direct or indirect client, and thus there is no obligation to enter into a contract.

## 5. Suspension of clearing obligation (Art. 6(b) new)

The EBF fully supports the introduction of a new provision via Article 6b allowing for the temporary suspension of the clearing obligation in situations other than resolution.

However, it should be further clarified in the proposal that the conditions under Article 6b (c) could be considered to be fulfilled where one or more CCPs lose their authorisation or recognition as a CCP under the EMIR Regulation.

Furthermore, the proposal currently only allows for a maximum suspension period of 12 months. It is however possible that the conditions that would lead to the suspension of the obligation could last for longer than this 12-month period. We would therefore recommend deleting the 12-month maximum limit, or to provide further rules that would address exceptional circumstances that may prevail.

## 6. Harmonise the reporting standards for trade repositories

In the EMIR REFIT, it is suggested to further harmonise the reporting rules. Many fields in the reporting templates, and especially the free text fields, remain big obstacles for the successful matching of trades. Furthermore, it remains a significant administrative burden to fill in the large templates. The EBF would suggest taking the harmonisation further by introducing a common EU Standard for reporting to trade repositories. This would reduce the administrative burden substantially and increase matching of trades.

In addition, it should be possible for financial counterparties to inform ESMA that they fulfil the requirements for big financial counterparties unless they inform ESMA otherwise. It is currently a requirement for all financial counterparties to inform ESMA yearly regarding their situation, which remains an administrative burden.

## 7. Obligation for Clearing Members to offer ISA to retail clients (Article 39 (5)

This obligation for clearing members to offer Individually Segregated Accounts (ISAs) is not restricted to derivatives, but is applicable for all financial instruments, including shares and bonds. It applies also to all clients/counterparties, including retail clients. As a result of the high operational costs involved in offering individual segregation, ISAs are only suitable for clients with a considerable trading volume. The costs of realising individual segregation would go far beyond what is bearable (economically justifiable) for retail investors; therefore, it would be extremely unlikely that they would opt for an ISA and in practice they will choose omnibus segregation. We think that banks shouldn't be obliged to offer (and build) costly ISAs in the retail market knowing that they are not suitable and far too expensive for retail clients.

Clients' assets are already protected, also in case of an omnibus account (OSA) on the basis of MiFID (Article 13, paragraph 7) and MiFID II (Article 16, paragraph 8). Therefore, from the point of investor protection this article is not needed.

Next to that the obligation to offer an ISA also for financial instruments like shares and bonds doesn't have a lot of added value. This because settlement of these transactions takes place at T+2 or even quicker. There are no long term outstanding positions as is the case with derivatives. We therefore propose to limit the obligation of clearing members to offer an ISA as meant in Article 39 (5):

- to financial counterparties and non-financial counterparties above the clearing threshold, and
- to derivatives contracts.

Our proposal for a modified text of Article 39 (5):

"5. A clearing member shall offer ~~its clients~~ **financial counterparties and non-financial counterparties as referred to in Article 10**, at least, the choice between omnibus client segregation and individual client segregation **with regard to its clearing services in derivatives contracts** and inform them of the costs and level of protection referred to in paragraph 7 associated with each option. The ~~client~~ **financial counterparty or non-financial counterparty referred to in Article 10**, shall confirm its choice in writing."

## 8. Disclosure of clearing costs (Article 38 (1))

The obligation to disclose the costs of clearing in Article 38(1) does not only apply to CCPs, but also to clearing members. Furthermore, its scope is not restricted to OTC derivatives, but includes all financial instruments, and it applies not only to (non-)financial counterparties, but to all counterparties and clients including retail clients and natural persons. The latter is conceptually difficult in practice: when servicing retail clients/investors, banks/brokers/intermediaries do not offer clearing services in isolation, but combine them with other services that cannot be unbundled. As this is a matter of cost disclosure with regard to financial services offered to retail investors, this belongs under the umbrella of MiFID II. This article should be limited in scope to what is meant to be regulated in EMIR, meaning CCP's, derivative contracts and (non-)financial counterparties. Next to that overlap with MiFID II including the detailed cost disclosure requirements in MiFID II should be prevented. By small changes in this article, this can be achieved.

Our proposal for a modified text of Article 38 (1):

1. A CCP ~~and its clearing members~~ shall publicly disclose the prices and fees associated with the services provided **with regard to derivatives contracts**. They shall disclose the prices and fees of each service provided separately, including discounts and rebates and the conditions to benefit from those reductions. A CCP shall allow its clearing members and, where relevant, their clients separate access to the specific services provided".