2 December 2019

**Final Draft**

# EBF Response to ESMA consultation - Draft technical advice on commercial terms for providing clearing services under EMIR (FRANDT)

## Introduction

***Please make your introductory comments below, if any***

The EBF welcomes the opportunity to comment on the proposal for a specification of the conditions under which the commercial terms under which clearing services are provided are to be considered to be fair, reasonable, non-discriminatory and transparent (FRANDT-requirements).

These requirements need to strike the right balance between the interest of clients in having unfettered access to clearing services on the one hand and the interests of clearing service providers. For example, as concepts such as reasonableness and fairness can only be assessed in relation to the prevailing market conditions, which can change over time, rendering FRANDT requirements unfit for purpose if they are calibrated too restrictively. This would likely also increase unnecessarily compliance costs, and it should be taken into account when drafting the rules

The consultation paper generally recognises this by addressing both the difficulties clients may face in getting access to clearing services and the considerable challenges and costs associated with establishing client clearing services. Again, it should be noted in this context that, apart from the factors mentioned under Section 4 of the Consultation Paper (in particular paragraph 23 to 27), the burdens associated with the constantly expanding complex regulatory requirements also work as a significant disincentive to establish or expand client clearing services.

On this delicate basis, any decreased access to clearing as a result of additional regulation should be avoided. In this, the EBF is convinced that the FRANDT-requirements should be carefully calibrated as to ensure a meaningful addition to the existing requirements for the provision of clearing services.

Another central aspect in this connection is the mitigation and management of the risks associated with clients and client positions. As effective and efficient risk management is of paramount importance, institutions will always need to perform a risk assessment exercise before considering whether to offer or expand client clearing services and assessing under what conditions these services to existing or new clients should be offered.

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It is also important that the FRANDT-rules do not result in a price regulation or an obligation to contract (cf. Recital 11 of EMIR Refit).

Furthermore, it should be taken into account that the conditions under which client clearing services can be provided are, to a considerable extent, determined by the relevant central counterparties (CCPs).

Having said this, we concur with the proposals made in the Consultation Paper to some extent.

However, certain aspects raise some concerns and should be reviewed in order to ensure that the FRANDT-requirements will ultimately achieve the intended purposes - thus facilitating the access to clearing services and encouraging institutions to offer client clearing services.

EBF's key concerns can be summarized as follows:

- Before adopting new delegated acts that would specify the conditions under which commercial terms in clearing agreements are considered to be fair, reasonable, non-discriminatory and transparent, the EBF believes that an assessment of the real impact of additional rules should be made, in particular considering whether further rules are needed in addition to the level 1 rules set out under EMIR.
- It should be taken into consideration how the introduction of such deeply prescriptive client classification criteria could negatively impact the service providers' ability to correctly apply their risk management policies. In fact, certain proposals would require changes to these frameworks with the consequence that clearers would have to unwillingly assume certain risks, affecting their participation in the clearing market, even leading to market-exit.
- Requirements regarding the contractual documentation used in connection with client clearing services, in particular the proposal to require the institutions to publish the contractual agreements even where these are standard industry documentations (here, a reference to such standard documents should be entirely sufficient and would be clearly more appropriate) and
- The requirement to include applicable statutory requirements in the contractual agreement itself

These elements could be counterproductive as they are likely to cause confusion and even legal uncertainty.

We would also like to make some comments regarding territorial scope of application of FRANDT requirements. OTC derivatives clearing is a global business and clearing services providers are competing in an international environment. For this reason, we wish to highlight the importance to achieve final FRANDT requirements that would facilitate an enforcement regime ensuring a fair level playing field between EU providers and their international competitors. An unlevel playing field would be a major threat for the competitive position of European clearing service providers, especially if European clearing service providers are required to be more transparent than third country competitors.

The consultation paper, in our view, does not provide enough clarity as to the territorial scope of application of the FRANDT requirements. We therefore wish to obtain a confirmation that the requirement will apply to all products in scope of Art. 4 of EMIR submitted to clearing on behalf of EU clients to any CCP authorised to provide clearing services in the EU. We wish to highlight the need for ESMA and the European Commission to ensure that the location of the clearing member or the location of the CCP does not preclude effective application of the requirement.

We are not certain that an effective application to third country clearing members (i.e. banks) authorised in the EU could be guaranteed. EBF is well aware that CCPs established in the EU currently represent a limited percentage of the total market. In any case, the guarantee of a level playing field is of paramount importance for European clearing service providers.

**Q. 1: Do you generally agree with the approach on transparency and how to publicly disclose fees and commercial terms and other conditions? Please elaborate and if you disagree with any specific requirement, please suggest alternative ones. You can also suggest additional ones.**

The EBF does not agree with publicly disclosing detailed fees, full commercial terms, and other conditions.

With special regard to the scope of disclosure requirements regarding general contractual terms (Section 6.1/para. 43 – Art. 2 (1) (c) and/or Art. 4 of the draft delegated act), the EBF has serious concerns over the proposed scope, in particular as far as this is also meant to include a disclosure of standard market documentations in their entirety.

The EBF agrees that institutions offering client clearing services should provide market participants with appropriate information on the contractual framework applicable to client clearing relationships. However, the publication of detailed fees and full commercial terms is unlikely to increase access to clearing. Generic disclosures without any reference to individual clients seldom provide a useful comparison and may potentially be misleading. Specifically, the EBF believes that the disclosure requirement should concentrate on necessary and not already available information such as specific contractual elements, which help the market participants to identify potential differences between the offers of various providers.

The requirement should not be extended to standard market client clearing documentations.

Regarding the documentation, as the Consultation Paper acknowledges, market participants regularly rely on the standard market client clearing documentations developed by various associations, such as standard forms for OTC client clearing that are published by FIA and ISDA and are subject to copyright protection. Market participants are well accustomed to such standard documentations and as financial instructions usually have considerable experience with these documents (not least because of their similarity with the standard market documentations for non-cleared transactions).. In fact, the disclosure is likely to make more difficult for market participants to compare offers and identify differences. Market participants would have more clarity if the disclosure focussed on the other contractual elements not already/generally known.

Since standard documentations are constantly under adjustments, there is also the risk of confusion and misunderstandings. Standard documentations consist of more than one element. They often consist of general terms or a master agreement addressing the general aspects of the contractual relationship, including the netting provisions, and further documents, such as collateral annexes and other annexes, and supplemental agreements. New elements are added from time to time (sometimes with very short notice where required by regulatory or legal developments) and existing elements might be amended and modernised.

Thus, the standard client clearing documentations will always be subject to changes and adjustments. Institutions using these documentations will review and adjust the

documentation they intend to use for client clearing services accordingly (amendments and changes can of course only be included into existing contractual relationships with clients in accordance with their terms and upon the consent of the client).Therefore, the disclosed standard documentation is likely to give an incomplete and misleading impression of the documentation actually used.

The disclosed information on the standard documentation can also be misleading and incomplete as the documentation is always negotiated and will be individualised and completed by the individual arrangements agreed upon during the negotiations.

Against this background, the EBF believes that the disclosure requirement regarding general contractual terms should, as regards standard documentations, be limited to a requirement to clearly indicate the type of standard documentations an institution is willing to use (which may include a reference to a website where the documentation is explained and/or published) for client clearing purposes and information on any institution specific standard additions and modifications (thereby actually providing more clarity on the differences in the offers between the various clearing service providers).

On a more general note, it should be taken into consideration that institutions are already subject to numerous and often duplicative information requirements covering the risks connected to clearing. For example, under art. 27 of RTS 6 of MiFID II, clearing firms are required to publish high level summaries of the key terms that they have in the clearing documentation.

**Q. 2: Do you generally agree with the elements to be taken into consideration in the commercial terms for the provision of clearing services? Please elaborate and if you disagree with any specific element, please suggest alternative ones. You can also suggest additional ones.**

The EBF is concerned over the following items:

1. Scope of disclosure requirements regarding standardised commercial terms in standard documentations (Section 6.2/para. 65 et seq. – Art. 2 (1) (c) and/or Art. 4 of the draft delegated act)

The comments under Q1 regarding general contractual terms and standardised documentations apply correspondingly. In addition, we wish to highlight that the proposals limiting clearers' ability to determine such contractual terms, in particular regarding termination and risk controls, are contradictory with the principle "no obligation to contract" which FRANDT is meant to be based on.

More specifically, taking into account the high level of customization and personalization of clearing agreements, relying on a standard set of documents is likely to hinder the effectiveness and reasonableness of the review process sought by the same delegated act.

In addition, the EBF believes that specific requirements, as set out in the proposed Art. 4 of the proposed delegated act, are too detailed and may leave little room for adjustments to contractual practices of the relevant applicable law and/or already existing market practices (primarily evidenced by standard market documentations).

2. Replication of local law (Section 6.2 para. 65 – Art. 4 (4) of the draft delegated act)

The EBF has stark concerns over the proposal to require the 'replication' of the contents of applicable local law:

Namely, on top of being contrary to current widespread operational processes and to how agreements are drafted and interpreted in many EU jurisdictions, replicating statutory/legal requirements in a contractual agreement bears the risk that these replicated statutory/legal requirements may become contractual terms. This would raise very serious and difficult questions on the legal nature of these statutory/legal requirements, especially in case they change (while the contractual agreement in place remains unchanged).

This would make the contractual agreement confusing and simply too difficult to apply and understand: a contractual agreement, as a legal instrument, should only include provisions which are of a contractual nature and these should not be mixed with statutory law or purely informational content.

In this context, it should be taken into account that market participants are regulated entities and are used to references to regulatory/legal requirements and therefore capable of understanding and implementing them.

Should it nevertheless be deemed necessary to provide the market participants with information on these statutory/legal requirements, institutions should be permitted to do this via a clear reference to the law in question or at least via references to a website or via a separate (non-contractual) informational document.

3. Termination provisions (Section 6.2 para 74 – Art. 4 (3) of the draft delegated act)

As regards the requirements concerning termination provisions, it should be taken into account that a termination may – under certain circumstances – be required and merited with immediate effect or very little advance warning (especially where mandated under applicable law).

This should be clarified in order to prevent misconceptions.

Moreover, the requirement that the notice period upon termination should be at least six months is not aligned with CCPs' termination period and the basic principle that clearing firms acts as riskless principals. As a minimum of prudent risk management, termination notice periods need to mirror the CCPs' notice period.

It should be further noted and acknowledged that the contractual arrangements may be subject to and/or rely on legal concepts existing in the relevant applicable law with regard to contractual termination rights.

4. Contractual agreement applicable though life of contracts – Art. 2 (4) (c) of the draft delegated act

The proposed Art. 2 (4) can be misunderstood as prohibiting any change to existing agreements. While it is true that amendments will generally be possible only with the consent of the counterparty, there may be circumstances which may require a unilateral right to make adjustments, for instance in case of changes which are required to ensure the continued clearing of transactions (in particular if required under the rules and regulations of a CCP) or any changes required to ensure regulatory compliance.

**Q. 3: Do you generally agree with the suggestions to assist in facilitating access to clearing services? Do you generally agree with the requirements listed to ensure prices are fair, proportionate and non-discriminatory? Please elaborate**

**and if you disagree with any specific element, please suggest alternative ones. You can also suggest additional ones.**

The EBF disagrees. In addition to what has been mentioned above, fees that clearing services providers charge their customers with are not standardised and we do not consider such standardisation across all service providers to be feasible. In fact, they deviate depending on a range of different factors including onboarding requirements and IT-integration. Moreover, technical requirements deviate between different customers. Therefore, it remains of paramount importance that the imposed requirements do not entail the need to rebuild existing IT-infrastructure. In addition, it should be noted that clearing services often are an ancillary service to other services provided by the institutions.

As mentioned, the introduction of prescriptive client classification criteria would severely impact service providers' ability to adapt their risk management policies and could affect their participation in the clearing market. Unfortunately, it is very difficult to price clearing services on the basis of different customer categories. A range of different factors need to be taken into account, including different risk criteria, volume, type of product, etc.

Clearing firms also have their own risk policies and offer different products in different markets; their offerings and risk criteria are therefore not comparable and develop over time on the basis of the laws and regulation that govern the clearing firms' operations.

The EBF also object to the requirement in paragraph 85 that clearing firms should disclose the costs assumed by clearing firms in providing clearing services. On top of the fact that this is highly sensitive commercial information, it should be noted that clearing firms are already subject to the costs and charges rules under MiFID II, which requires firms to disclose costs to clients.

**Q. 4: Do you generally agree with the proposed elements regarding the risk control criteria? Please elaborate and if you disagree with any, please suggest alternative or additional ones.**

The EBF does not see a stringent need for additional regulation in this area. In fact, clearing firms are already subject to the client risk assessment requirements in RTS 6 of MiFID II.

**Q 5: Do you identify other benefits and costs not mentioned above associated to the proposed approach (option 2)? If you advocated for a different approach, how would it impact this section on the impact assessment? Please provide details.**

As mentioned above, the EBF is concerned additional rules, specifying the conditions under which the commercial terms are considered to meet the FRANDT requirements, might prove unlikely to produce an increased access to clearing.

However, should ESMA be willing pursue the implementation of additional rules, the EBF would support the approach proposed under option 1, i.e. to establish limited conditions with requirements under which commercial terms are to be considered – thus merely supplementing the current framework.

In this respect, it is important to assess to what extent FRANDT overlaps with the current regulation.

Moreover, considering the changes that have been introduced through EMIR Refit with the introduction of the small financial counterparty (SFC) category and the amendments made with respect to non-financial counterparties (NFC), the EBF also questions whether the initial concern regarding access to clearing services for counterparties with a limited volume of activity in the OTC derivatives market remain. In this, the Federation encourages ESMA to inquiry whether the problem still exists and to analyse whether the high costs of implementing the proposed rules are worthwhile.

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**About the EBF**

The European Banking Federation is the voice of the European banking sector, bringing together 32 national banking associations in Europe that together represent a significant majority of all banking assets in Europe, with 3,500 banks - large and small, wholesale and retail, local and international – while employing approximately two million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that reliably handle more than 400 million payment transactions per day. Launched in 1960, the EBF is committed to a single market for financial services in the European Union and to supporting policies that foster economic growth.

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