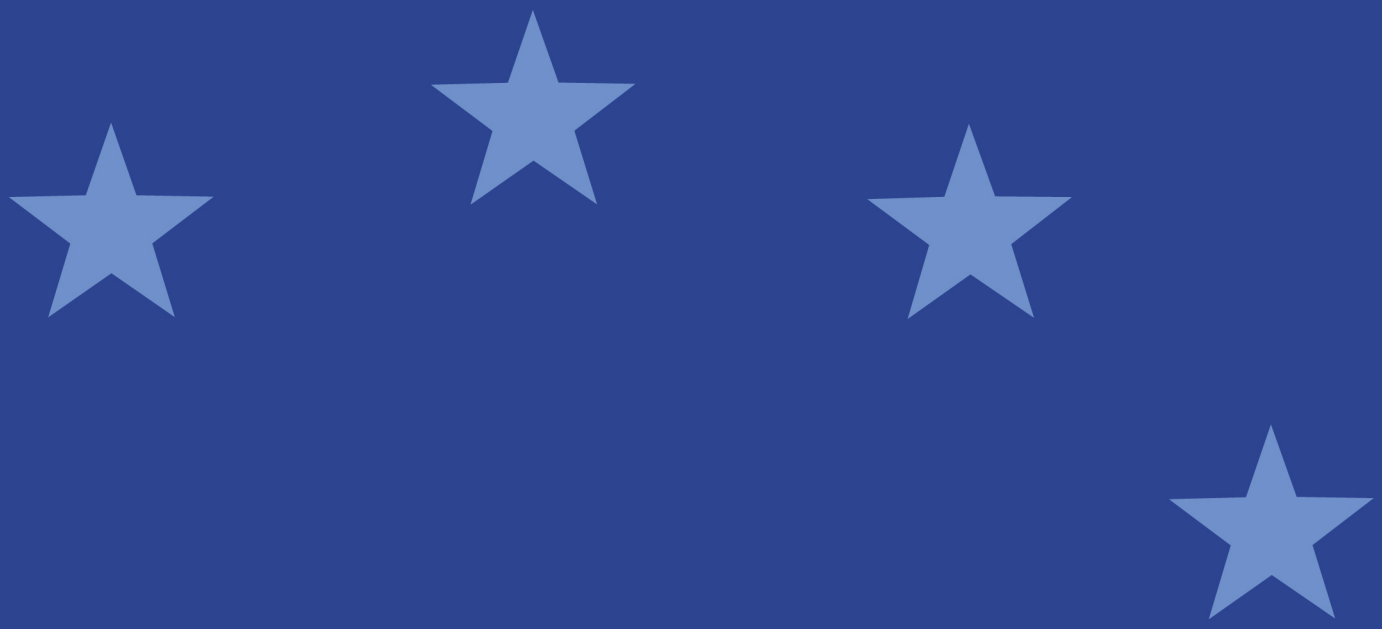
esma European Securities and Markets Authority

Reply form to the Consultation Paper on the Clearing Obligation under EMIR (no. 1)



11 July 2014|2014/799 Reply Form

European Securities and Markets Authority

Date: 11 July 2014
2014/799 Reply Form

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the questions listed in the Consultation Paper on the Clearing Obligation under EMIR (no. 1), published on ESMA's website.

Comments are most helpful if they:

- respond to the question stated;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

To help you navigate this document more easily, bookmarks are available in "Navigation Pane" for Word 2010 and in "Document Map" for Word 2007.

ESMA will consider all comments received by **18 August 2014.**

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

How to use this form to reply

Please note that, in order to facilitate the analysis of the responses, ESMA will be using an IT tool that does not allow processing of responses which do not follow the formatting indications described below.

Therefore, in responding you are kindly invited to proceed as follows:

- use this form to reply and send your response in Word format;
- type your response in the frame "TYPE YOUR TEXT HERE" and do not remove the tags of type <ESMA_QUESTION_1> Your response should be framed by the 2 tags corresponding to the question; and
- if you have no response to a question, do not delete the tags and leave the text "TYPE YOUR TEXT HERE" between the tags.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading 'Legal Notice'.

Who should read this paper

All interested stakeholders are invited to respond to this consultation paper. In particular, responses are sought from financial and non-financial counterparties of OTC derivatives transactions which will be subject to the clearing obligation, as well as central counterparties (CCPs).

General information about respondent

Name of the respondent	Federation of Finnish Financial Services
Are you representing an association?	Yes
Activity	Other Financial service providers
Country/Region	Finland

Introduction

Please make your introductory comments below:

<ESMA_COMMENT_1>
The Federation of Finnish Financial Services (FFI) represents banks, insurers, authorized pension companies, finance houses, securities dealers and financial employers operating in Finland. Its members also include employee pension, motor liability and workers compensation insurers, all three providers of statutory insurance lines that account for much of Finnish social security. In the light of this consultation, we represent a wide range of financial counterparties.

We understand that ESMA had to publish the consultation papers on clearing obligation in time following the authorization of central counterparties. However, we would like to point out that this summer has been extremely busy with several consultations touching derivatives markets, either by ESMA or by all three ESAs. This massive workload has led to a situation where at least in small and medium sized financial markets, such as Finland, entities active in the derivatives markets are not able to properly analyse the effects of these proposals. Therefore clear and workable phase-in periods are exceptionally important. We also ask ESMA to remain as flexible as possible with these rules in case they prove unworkable by the time of implementation.

Beginning of mandatory clearing will be massive change to the whole market even though some classes are already rather widely cleared on a voluntary basis. Hence, and taking into account the current regulatory burden on market participants, we are pleased to see that the ESMA will at first only consider mandatory clearing based on the bottom-up approach only. This will make it easier for the markets to adjust to the mandatory clearing as they will be able to use existing solutions to a large extent. Even with this approach, it must be borne in mind that many counterparties, especially smaller financial counterparties and NFC+ will start clearing for the first time. For these entities, it will be a huge change. In addition, existing clearing members and central counterparties will need to start providing clearing services to a much more diverse clientele than before.
<ESMA_COMMENT_1>

1 The clearing obligation procedure

Question 1: Do you have any comment on the clearing obligation procedure described in Section 1?

<ESMA_QUESTION_1>
FFI is pleased that ESMA has decided to group derivatives into five asset classes and consult based on this categorization. Indeed, it will help market participants to consider the effects of any clearing obligations in more targeted manner and more efficiently than if all were consulted separately after each CCP authorization.

We also welcome the attempt to capture all classes notified by CCPs belonging to the same type of asset class in a single consultation and also one single regulatory technical standard (RTS) on the clearing obligation for such asset class. It should be borne in mind that the operational implementation of the clearing obligation would become even more complex and challenging, if clearing obligations in respect of certain products belonging to the same asset class were to become effective at different times over a period of time with varying or overlapping phase-in periods or dates of application of the frontloading requirement.

Any future re-assessments and assignments of clearing obligations to new products and currencies will have to be communicated in due time before the entry into force. This is important especially for smaller and medium-sized entities, but also for clearing members.
<ESMA_QUESTION_1>

2 Structure of the interest rate derivatives classes

2.1 Characteristics to be used for interest rate derivative classes

Question 2: Do you consider that the proposed structure defined here for the interest rate OTC derivative classes enables counterparties to identify which contracts fall under the clearing obligation as well as allows international convergence? Please explain.

<ESMA_QUESTION_2>
The proposed structure seems clear. We especially appreciate the fact that the structure is consistent with other jurisdictions. Consistency and convergence are very important in derivatives markets which are extremely global by nature and where already, and as noted in several earlier consultation responses, flows have moved to more flexible jurisdictions when differences in the scope of the rules have existed.

We strongly support the proposal in point 24 on page 12. In case more product types (such as swaptions, caps, floors and inflation swaps) are considered against the clearing obligation in the future, they will need to be consulted separately and categorized into additional classes of interest rate OTC derivatives.
<ESMA_QUESTION_2>

2.2 Additional Characteristics needed to cover Covered Bonds derivatives

Question 3: Do you consider that the proposed approach on covered bonds derivatives ensures that the special characteristics of those contracts are adequately taken into account in the context of the clearing obligation? Please explain why and possible alternatives.

Stakeholders (CCPs and covered bond derivatives users, in particular) are invited to provide detailed feedback on paragraph 38 above. In particular: what is the nature of the impediments (e.g. legal, technical) that CCPs are facing in this respect, if any? Has there been further discussions between CCPs and covered bond derivatives users and any progress resulting thereof?

<ESMA_QUESTION_3>
The proposal takes quite adequately into account the characteristics of covered bond derivatives and the conclusion is correct. However, some fine-tuning could be done to ensure an even workable approach both in terms of clearing obligation and in the risk mitigation scheme for non-centrally cleared derivatives. Following the more technical approach in this consultation, we were able to analyse the workability of these schemes even more. These comments apply also to the proposals in consultation on non-centrally cleared derivatives. We therefore ask ESMA to ensure that the latest comments and analysis from this consultation are properly discussed in the joint ESAs work around the proposals in the consultation for non-centrally cleared derivatives, too.

According to the proposed wording, the exception would apply to contracts associated to covered bond[s] programmes. Covered bonds do not always need to be issued under an offering programme. Based on the considerations presented as grounds for the proposed exception, it is hard to see the relevance of a limitation as to the technique how the covered bonds have initially been issued. Maintaining such a differentiation would also be challenging from both the issuers' and the supervisors' point of view. We therefore suggest that the requirement should be amended to merely refer to "contracts associated to covered bonds when such contracts…". The same goes for the references to covered bond programmes further on in the draft article.

The requirements that are referred to in the proposed point 54 (e) (Article 129 of Regulation (EU) No 575/2013) apply to covered bonds, not to covered bond programmes and the collateral requirements referred to in the proposed point 54(f) are as far as we know generally not (at least not in the Finnish legislation) calculated separately for each offering programme, but on a total cover pool level. Therefore we also propose that the expression "covered bond programme" in (c), (e) and (f) be replaced with

"covered bond" (or "covered bonds", where appropriate). If needed, the expression "covered bond" could be defined by referring to Article 52(4) of Directive 2009/65/EC (like in Article 129 of Regulation 575/2013).

According to the first requirement (point 54 (a), it seems that no event of default (e.g. payment default) relating to the issuer would be permitted. This requirement would be incompatible with market practice and reach beyond the requirements applied by the rating agencies for AAA compliant covered bond related derivatives. The expression "are not terminated" in point 54(a) seems linguistically to imply that the exception would apply only to contracts where a right to terminate does exist as such, but is not exercised. A better expression would be "will not terminate".

The purpose of this restriction should be to avoid that the derivative is terminated as a result of the issuer's insolvency, not to prevent the counterparty from terminating upon other limited non-insolvency related defaults. Therefore we propose that the words "insolvency related" are added before "default" in paragraph (a) of point 54.

Regarding point 54 (f) we believe it should be sufficient to have a de facto 2% over collateralisation and not a necessity to have a legal requirement in each jurisdiction. If however the proposed reference to a legal requirement is upheld, it would in any case be necessary to clarify that the 102 % requirement can be fulfilled both through a legal requirement that measures the nominal value of the cover pool items and one that is based on net present values (like the Finnish one), for example by adding "…102%, calculated either based on nominal values of the items registered in the cover pool or based on net present values of the cash flows of the cover pool".

The clearing and other risk management procedures in EMIR and in the EU delegated legislation issued under EMIR (such as the draft RTS) only applies to derivatives transactions which involve two or more counterparties. Hence, the rules do not apply with respect to derivatives transactions entered into within the same legal entity (see ESMA's response to TR Question 14 in the EMIR Q&A published by ESMA on 23 June 2014). If, in accordance with national legislation and upon prior approval by its competent authority, a bank issues covered bonds on its own balance sheet and internally hedges the risks relating to such covered bond issues, all such hedging arrangements are made within the same legal entity. It would be both desirable and advantageous to clarify that the RTS does not apply to such internal hedging transactions.
<ESMA_QUESTION_3>

2.3 Public Register

Question 4: Do you have any comment on the public register described in Section 2.3?

<ESMA_QUESTION_4>
The considerations made by ESMA in the consultation paper cover all the key factors in the respect of the public register. The importance of a rapid removal of clearing obligations cannot be stressed enough. It is extremely crucial to find a workable, more flexible solution for the removal in the coming EMIR review.

However, we remain cautious whether any amendments based on the review will be implemented soon enough. EMIR review will most likely be highly debated due to many outstanding issues. Therefore we urge ESMA to find a way to go round these limitations and build a robust system together with the co-legislators as soon as possible and before any clearing obligation enters into force.
<ESMA_QUESTION_4>

3 Determination of the OTC interest rate classes to be subject to the clearing obligation

Question 5: In view of the criteria set in Article 5(4) of EMIR, do you consider that this set of classes addresses appropriately the systemic risk associated to interest rate OTC derivatives? Please include relevant data or information where applicable.

Please include relevant data or information where applicable.

<ESMA_QUESTION_5>
As a starting remark, we see that ESMA has done excellent work in analysing the markets from every angle required by the EMIR RTS. Current consultation paper provides for very useful statistics and reasoning for the market participants which help to understand the background for ESMAs decisions.

We would like to point out one issue that has been recently discussed and which could be considered by ESMA when the amount of current clearing members is analysed in connection with setting the clearing obligation. Many small and medium sized clearing members have recently started their inner analysis as to whether it is possible to remain as a general clearing member. They are worried that they might not be able to act as GCMs in the future. There are several reasons for this: the introduction of clearing obligations where one might need to establish clearing relationships to new CCPs, segregation requirements and new account structures, possible new organisational requirements under MIFID II regime, capital requirements and amendments to CCP rules following their EMIR authorization and general consolidation trend. Therefore it makes sense for ESMA to base its judgments on significantly lower number of clearing members than there are today. ESMA could test its views with for example 30 % portion of today's clearing members.
<ESMA_QUESTION_5>

4 Determination of the dates on which the obligation applies and the categories of counterparties

4.1 Analysis of the criteria relevant for the determination of the dates

Question 6: Do you have any comment on the analysis presented in Section 4.1?

<ESMA_QUESTION_6>
No comments.
<ESMA_QUESTION_6>

4.2 Determination of the categories of counterparties (Criteria (d) to (f))

Question 7: Do you consider that the classification of counterparties presented in Section 4.2 ensures a smooth implementation of the clearing obligation? Please explain why and possible alternatives.

<ESMA_QUESTION_7>
The classification seems workable and takes into account several different factors in the OTC clearing space. We still would like to raise awareness of the issue that volume is a proxy for service provider interest for both CCPs and clearing members. It might be that largest NFC+ from category 3 are far more interesting from a CCP's or clearing member's perspective than smallest financial counterparties belonging to category 2. It is worth for ESMA to follow closely the market developments in this respect.

In addition, we would like to bring to ESMA's attention problems that have arisen since one of the latest EMIR Q&A documents. The existing interpretation of financial and non-financial entities poses significant problems that increase the administrative burden and costs but does not bring any benefits. One of these is related to alternative investment funds. According to the ESMA Q & A on EMIR, closed ended AIFs managed by authorized AIFMs will be seen as financial counterparties. This interpretation should be

reconsidered. The status of a fund has to depend on the AIF itself (if the fund is exempted from the scope of the AIFMD, it should be a non-financial counterparty according to EMIR).

ESMAs decision to view closed ended AIFs as financial counterparties has caused unnecessary burden and will increase costs in an unexpected way. These closed AIFs will now face extra costs due to especially the clearing obligation. The costs are only applicable because of practical choices that especially smaller investment firms have made in the past. At the time these decisions were made, these investments firms did not have any knowledge of this detrimental future interpretation rule made under EMIR.
<ESMA_QUESTION_7>

4.3 Determination of the dates from which the clearing obligation takes effect

Question 8: Do you consider that the proposed dates of application ensure a smooth implementation of the clearing obligation? Please explain why and possible alternatives.

<ESMA_QUESTION_8>
No, it does not allow for smooth implementation for category 1. We believe that for the first clearing obligations, a phase in of 12 months is needed, especially as ESMA decided on the wide interpretation of clearing member's clearing obligation in section 4.2.1. A workable phase-in period for these entities is 12 months as indicated by most of the respondents earlier. ESMA has already seen a notable voluntary move to clearing and hence a 12-months phase-in would leave more room for more balanced entries within the timeframe. With the proposed 6 months the market will see a rush for clearing that does not support the aim of prevention of systemic risk. A 12 months period would also be well in line with what has been proposed for risk mitigation techniques for non-centrally cleared derivatives contracts.

For categories 2 and 3, the proposals seem workable and proportionate. In case the phase-in for category 1 is extended to 12 months, it might be useful to leave more room for the next category 2 to start clearing and following this, the phase-in for category 2 could be lengthened accordingly to 24 months (two years).

Please also see our answer to question 9 where some counterbalancing could be done if the frontloading obligation is limited.
<ESMA_QUESTION_8>

5 Remaining maturity and frontloading

Question 9: Do you consider that the proposed approach on frontloading and the minimum remaining maturity ensures that the uncertainty related to this requirement is sufficiently mitigated, while allowing a meaningful set of contracts to be captured? If not, please explain why and provide possible alternatives compatible with EMIR.

<ESMA_QUESTION_9>
FFI welcomes the clarification that contracts concluded with non-financial counterparties are not subject to frontloading obligation. However, even with the decision to only apply frontloading to a limited number of contracts within the Option B (between the publication in the Official Journal of the RTS and the date on which the clearing obligation takes effect (the date of application)) the market will face many difficulties that risk undermining the phase-in period that is granted for category 2 entities.

These challenges are similar to the once described in section 224, including the economic effect of switching collateral already posted relative to the maturity of the contract and also the difference on initial margin and variation margin posted under a bilateral set-up vs. a central clearing set-up. It will require significant legal and operational measures to meet these requirements.

We strongly advice that ESMA does not impose frontloading obligation on any category 2 entities in order to avoid great uncertainty related to frontloading and risk for market disruption. We believe that in case ESMA does not impose the frontloading obligation on category 2 entities, the phase-in period can be shortened and thus this counterbalances the lack of frontloading obligation.

Therefore one of the following phase-in models should apply, depending on the scope of the frontloading obligation:

Option A: Frontloading does not apply to category 2 entities. Category 1 entities would have at least 9 to 12 months phase-in period. Category 2 entities will have a 12 month phase-in period. Category 3 would have the proposed phase-in period of three years.

Option B: Frontloading applies as proposed. Category 1 entities have 12 months phase-in period. Category 2 entities will have 24 months phase-in period. Category 3 entities have 36 months to prepare for the clearing obligation.
<ESMA_QUESTION_9>

6 OTC equity derivative classes that are proposed not to be subject to the clearing obligation

Question 10: Do you have any comment on the analysis on the Equity OTC derivative classes presented in Section 6?

<ESMA_QUESTION_10>
The analysis takes duly into account the characteristics of the equity derivatives markets. At the time being, they are not significant from a systemic risk perspective.
<ESMA_QUESTION_10>

7 OTC Interest rate future and option classes that are proposed not to be subject to the clearing obligation

Question 11: Do you have any comment on the analysis on the OTC Interest rate future and options derivative classes presented in Section 7?

<ESMA_QUESTION_11>
We agree with the analysis and the conclusions drawn.
<ESMA_QUESTION_11>

Annex I - Commission mandate to develop technical standards

Annex II - Draft Regulatory Technical Standards on the Clearing Obligation

Question 12: Please indicate your comments on the draft RTS other than those already made in the previous questions.

<ESMA_QUESTION_12>
No further comments than those already made.
<ESMA_QUESTION_12>

Annex III - Impact assessment

Question 13: Please indicate your comments on the CBA.

<ESMA_QUESTION_13>
No further comments.
<ESMA_QUESTION_13>