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FFI | Federation of Finnish Financial Services

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The Federation of Finnish Financial Services 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.

European Securities and Markets Authority

FFI RESPONSE TO THE CONSULTATION PAPER ON THE REVIEW OF THE TECHNICAL STANDARDS ON REPORTING UNDER ARTICLE 9 OF EMIR

The Federation of Finnish Financial Services (hereinafter "FFI") welcomes the opportunity to respond to the ESMA consultation paper on the review of the technical standards on reporting under article 9 of EMIR.

For your reference we will attach to our response also a reporting experience report drafted in spring 2014. Many of the issues faced back then are still very relevant.

Key points

- Implementation of EMIR reporting obligation and the experiences therefrom are not very promising. Still after almost a year of reporting the reporting system suffers of many defaults and imperfections.
- Some of the problems are caused by the too wide scope of the reporting obligation, some by the decisions made in the technical standards, some by the lack of detailed guidance from ESMA and some by the technical readiness at the trade repositories.
- In general, the reporting obligation has become very costly to the industry. In terms of a single transaction, the reporting obligation consists of several cost factors. It includes for example the cost to obtain an LEI code[1], the work to gather all required information and the efforts to fill in the right details and the problems by the trade repositories to take in data and send a confirmation etc. The time needed to report one transaction has been varying from some 15 minutes to hours of work at one counterparty only.
- According to EMIR article 85, a review of the regulation is set for August 2015. Bearing in mind the revolution EMIR has caused to the derivatives markets and that it is one of the first regulations with a massive amount of delegated regulations drafted by ESMA (or other European supervisory authorities) we believe that a more in-depth analysis of EMIR would have benefited also this review by ESMA.
- We value the efforts by ESMA to fix some of the uncertainties with this review of the technical standards. However, as there are many causes to these problems, a thorough impact analysis by all regulators should have been made first. This would be crucial to avoid making technical changes that might actually not be needed should some more political amendments be made. This applies especially to the proposals to start listing very detailed corporate sectors for NFCs.
- The biggest obstacle for easy reporting obligation seems to be the requirement for both counterparties to report a trade. Most of this problem is caused by ESMA itself while requiring two complete sets of counterparty data. If ESMA were to amend the technical

[1] This cost is quite large in proportion to small counterparties that only do a few hedging transactions.

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standards, this should be amended so that only one counterparty data report would be enough.

- Such a proposal would not be contradictory to level 1 text but could support the introduction to a more simple level 1 rule in the review as well.
- As a whole, the proposals in the consultation paper contain good clarifications where existing points are slightly amended. Introduction of completely new fields however seems to cause extra burden on even those few companies that have somehow been able to cope with the current obligation and where reporting goes pretty well for the time being.
- Therefore we question the need to add on new fields to an already complex structure. Instead, any fields that are covered with existing codes or do not pose a real value from a systemic risk perspective (such as reporting on margins from both sides by both parties) should be deleted.
- Furthermore, we would like to highlight the importance to avoid any double reporting requirements throughout the various reporting needs. ECB has recently published a Regulation on money market statistical reporting (MMSR), which includes daily transaction reporting on FX swaps and overnight index swaps. This data could be derived from EMIR data. We encourage ESMA to align its reporting requirements with those of the ECB. Currently attributes are very similar, but definitions are slightly different. This is very difficult for the banking industry since the data will be derived from the same sources. Attributes should be made identical. Furthermore, we hope that the ECB and ESMA would work together to find a workable solution to re-use EMIR data for the ECB purposes.

In addition to these crucial key points please find below our responses to the detailed questions.

FFI Responses

Q1: Do you envisage any difficulties with removing the 'other' category from derivative class and type descriptions in Articles 4(3)(a) and 4(3)(b) of ITS 1247/2012? If so, what additional derivative class(es) and type(s) would need to be included? Please elaborate.

No comments.

Q2: Do you think the clarifications introduced in this section adequately reflect the derivatives market and will help improve the data quality of reports? Will the proposed changes cause significant new difficulties? Please elaborate.

These clarifications are welcome and will make the reporting obligation a bit easier to fulfill from a technical perspective. However, the term reporting counterparty might be misleading in cases where the reporting obligation has been outsourced. It might be useful to move the proposed field 10 (report submitting entity ID) to follow other ID fields (2 and 3) to clarify at an early stage if outsourcing has or has not been done.

Q3: What difficulties do you anticipate with the approaches for the population of the mark to market valuation described in paragraphs 21 or 19 respectively? Please elaborate and specify for each type of contract what would be the most practical and industry consistent way to populate this field in line with either of the approaches set out in paragraphs 21 and 23.

In general, situations where negative values have been used have caused problems and the possibility and guidance therein is welcome.

Proposed amendment concerning Futures in paragraph 21 is not in line with the treatment of margin. In the context of futures and the treatment of margin the difference between purchase- and valuation moment, not the market value is used. The market value can be also negative if it is calculated by using the difference between purchase and valuation moment.
It is our understanding that at least for Swaps the proposal on “replacement cost of the contract” is the correct one. However, we are at this stage unsure whether it is suitable for other instruments.

Q4: Do you think the adaptations illustrated in this section adequately reflect the derivatives market and will help improve the data quality of reports? Will the proposed changes cause significant new difficulties? Please elaborate.

The text in the analysis seems to state that client codes should not be allowed for private individuals. This cannot be the case and seems to be an error in the text compared to the new Annex and the description therein.

The endorsement of the use of LEI codes is a welcome clarification. Financial sector counterparties have struggled in trying to explain to their counterparties the legal nature of the use of LEI codes as it is stated in the ESMA Q&A and in a way that can be interpret in multiple ways in the Commission Delegated Regulation (EU) No 148/2013. However it must be kept in mind that the cost to obtain an LEI code for example a rather small IRS hedge might become an obstacle for hedging. Therefore the fees for LEI codes should be constantly lowered or be used everywhere where recognition of several types of counterparties is needed.

Furthermore with respect to contracts entered into before EMIR regulation entered into force it should be noted that banks do not have means to compel clients to use LEI. In this context the use of LEIs should not be mandatory. In these, rather exceptional cases the technical readiness at the trade repositories should allow for use of other client codes without disapproving the whole report.

Use of LEI codes only should mean that all other fields defining the country of counterparties, domicile of counterparties, names, corporate sector etc. should be left blank when LEI is used. Please also see more on corporate sector.

In general we think that many adaptations are welcomed. Clarification on how time periods are reported is good. “Notional Amount” and “Original Nominal Amount” are also needed.

New “Action Type Correction” would be a step into right direction. Nowadays actions are cancelled through “ERROR.

Q5: Do you think the introduction of new values and fields adequately reflect the derivatives market and will help improve the data quality of reports? Will the proposed changes cause significant new difficulties? Please elaborate.

They will cause difficulties or at least minimize the benefits the market will now have from the introduction of LEI codes. With the LEI code, competent authorities should have the means to access the reports.

The introductions of new fields relating to notional values seem useful.

We would like to question the need to report both posted and received margins in the counterparty reports to avoid additional matching challenges. In general the clarification to report both posted and received collateral is welcomed. However, it should be enough to report only posted or received margin in one counterparty report. On matched or paired basis, the NCAs will then be able to get the whole picture without risk for many misunderstanding and mistakes caused by the current proposal.

In the new field 74 it is ensured that events can be reported either on trade or position basis. In the rare case of completely identical contracts position basis could work. However as the level of reporting needs to be agreed to between the counterparties, some differentiating views may occur. Reporting at position level could also require an own UTI for the position? Taking into account these challenges, reporting at trade level might be more clear and useful.

It should be remembered that the existing pairing problems are to a large extent caused by the regulators (both parties are obliged to report) and by the trade repositories (they have not been able to match trades within themselves or with other trade repositories). These problems require more actions than only the clarification around unique trade identifiers.

Q6: In your view, which of the reportable fields should permit for negative values as per paragraph 40? Please explain.

There should be a possibility to report market values as positive or negative. In case the market value is close to zero, it is difficult to deduct a market value provided by the counterparty without plus or minus sign. On the other hand, pricing errors in larger values are not revealed without plus or minus sign.

Q7: Do you anticipate any difficulties with populating the corporate sector of the reporting counterparty field for non-financials as described in paragraph 42? Please elaborate.

Yes. This introduction will be extremely costly and only make the reporting obligation more complex. Introduction of corporate sector will require more information to be provided or collected by one or both of the counterparties. This value does not bring enough value from a systemic risk perspective taking into account the extremely wide scope of the reporting obligation and the lack of any thresholds. It is our opinion that the NCAs do know the companies that exceed thresholds pretty well. This is also justified by the fact that most likely these companies have been placed under FSA or similar supervision since the EMIR has entered into force.

It should also be noted that this proposal is completely against the rule of thumb in the existing RTS. The proposals itself should already be accompanied with new cost-benefit analysis as they do not fall under the scope of the described existing analyses made in 2012.

The scope of the reporting obligation is one of the issues that will need to be properly analyzed against systemic risk and proportionality principles in the upcoming EMIR review. With this in mind, ESMA should not include these additional requirements at this stage in the process but it should avoid guidance from a more political level to ensure good conditions for corporates in Europe.

Q8: Do you envisage any difficulties with the approach described in paragraph 45 for the identification of indices and baskets? Please elaborate and specify what would be the most practical and industry consistent way to identify indices and baskets.

No comments.

Q9: Do you think the introduction of the dedicated section on Credit Derivatives will allow to adequately reflect details of the relevant contracts? Please elaborate.

No comments.

Q10: The current approach to reporting means that strategies such as straddles cannot usually be reported on a single report but instead have to be decomposed and reported as multiple derivative contracts. This is believed to cause difficulties reconciling the reports with firms' internal systems and also difficulties in reporting valuations where the market price may reflect the strategy rather than the individual components. Would it be valuable to allow for strategies to be reported directly as single reports? If so, how should this be achieved? For example, would additional values in the Option Type field (Current Table 2 Field 55) achieve this or would other changes also be needed? What sorts of strategies could and should be identified in this sort of way?

No comments.

Q11: Do you think that clarifying notional in the following way would add clarity and would be sufficient to report the main types of derivatives: 60. In the case of swaps, futures and forwards traded in monetary units, original notional shall be defined as the reference amount from which contractual payments are determined in derivatives markets; 61. In the case of options, contracts for difference and commodity derivatives designated in units such as barrels or tons, original notional shall be defined as the resulting amount of the derivative's underlying assets at the applicable price at the date of conclusion of the contract; 62. In the case of contracts where the notional is calculated using the price of the underlying asset and the price will only be available at the time of settlement, the original notional shall be defined by using the end of day settlement price of the underlying asset at the date of conclusion of the contract; 63. In the case of contracts where the notional, due to the characteristics of the contract, varies over time, the original notional shall be the one valid on the date of conclusion of the contract. Please elaborate.

We support paragraph 56. It makes sense at least for swaps.

In paragraph 57 there is a need to define options in more detailed manner. This is because calculation of market value and treatment on equity-, interest rate- (cap / floor), bund future- or commodity option can

differ in detail.

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FFI'S EXPERIENCES FROM THE INITIAL STEPS OF DERIVATIVES REPORTING

Background

On 12 February 2014, the reporting obligation of derivative contracts entered into force as dictated by the European Market Infrastructure Regulation (EMIR, EU 648/2012). Derivative contracts will now be reported into specific trade repositories. The obligation is unusually wide in scope, as it concerns all companies using derivatives, regardless of their size, field of business, types of derivatives, or the sizes of contracts.

Start-up problems are clearly evident

The Federation of Finnish Financial Services (FFI) has collected feedback from its members regarding the initial month of the reporting process. FFI proposes that this feedback is taken into account when the reported data is examined, and that the start-up issues are tolerated as understandable and human, instead of systemic, as long as is required.

FFI supports increased market transparency

Throughout the process, FFI has supported the reporting obligation of derivatives, which would improve market transparency. However, certain details and tight schedules have increased burden for companies and made interpretation of legislation more difficult without good reason. We hope that this is used as a learning opportunity when new reporting obligations are drafted (such as the SFTR-proposal for example) and when EMIR is eventually reviewed.

Interpreting EU regulation is not easy

When it comes to comprehensive, large-scale pieces of EU regulation, EMIR is one of the first that will not only be directly implemented in the member states, but also involves extensive regulation on lower levels. Handling it requires exceptionally high judicial competence and resources that may not be readily available, especially in smaller companies.

Due to the regulatory nature of EMIR, government proposals and other law drafting material do not have their usual standing as interpretation guidelines in the implementation process. Regulatory authority is now with the EU and the instructions come mainly from EU supervisors rather than the national supervisory authorities. FFI is aware that the FSAs cannot give guidelines on the interpretation of EMIR and lower-level EU regulation, but all assistance has been received with gratitude.

We can nevertheless state that all in all, Finland and the other Nordic countries are well prepared for the reporting and strive to comply with it as well as possible.

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First month of reporting did not yield convincing experiences

Eye must be kept on the trade repositories

FFI member companies report to the two largest trade repositories: DTCC and Regis-TR. Some report to one of the two while some report to both. Regardless of the company's size and main field of business, the reporting of all contracts or some specific contracts has been outsourced to the counterparty, which in this case is usually a large international bank.

There have been reported difficulties in joining a trade repository. Occasionally, for instance, the repository has alleged that no joining application had been made. In some of the worst cases the connection was only established on the previous night before the obligation entered into force.

FFI has previously discussed the equality of access to the repositories. Applications should not be treated with unreasonable inequality, but it seems that companies have unfortunately still experienced prioritisation.

Hiccups in acknowledgement of receipt and matching

FFI members and Finnish companies are well prepared for the reporting, and will carry out their part of the process. However, in many cases the trade repositories have not sent an acknowledgement of a received report. Some outsourced reporting service providers cannot provide their customers with lists of reported trades and their details.

Matching between contracting parties in different trade repositories barely functions at all. According to some estimates, repositories are unable to match up to 60% of the contracts reported to them. One cause for these problems are different practices in different repositories, such as the use of upper and lower case letters, or the way these get mixed in the repositories' own reporting practices.

The matching requirement stems from the fact that EMIR requires both parties of the contract to report. In the name of free competition, each party can choose which repository to use, and therefore the two legs of the transaction have to be matched. This two-way reporting obligation is one of the largest challenges in the reporting process. Even outsourced reporting basically has to be done twice. This results in matching problems, and we therefore think it is worth considering if just one joint report would be enough to satisfy the reporting obligation.

Different identifiers carry problems, but PRH worked efficiently

An international Legal Entity Identifier (LEI) is required in the reporting of derivatives. Finland decided to establish a distributor for LEIs, and the task was well-suited for the Finnish Patent and Registration Office (PRH). Initiation of the distribution took time due to reasons innately related to the legislative process, but once the distribution began, PRH was quick and efficient in giving out LEIs.

The day before the reporting, European Securities and Markets Authority (ESMA) gave instructions for example on how a unique trade identifier (UTI) should be made. Unfortunately, these instructions deviated from the logic originally developed by ISDA, which is widely used in the market. The lateness of the instructions was also unreasonable. This should be avoided in the future; when interpretation notes are given to participants, they must come well in advance so that they can be taken into account in the development of IT systems.

The way trade data and details of a single product are registered can vary between registers. A swap contract can be pointed out as an example; in DTCC the trade data and trade details are reported separately on their own lines, whereas in Regis-TR, one combined line suffices. These kinds of differences are likely the main reason why matching between different registers does not work as expected.

The definition of derivatives continues to cause interpretation difficulties. Many companies are still pondering which of their contracts need to be reported. With this in mind, when the time comes to examine the definition of derivatives during the revision of MiFID, we encourage the Commission to be as precise as possible in its analysis and regulation. When new regulation is drafted in the future, such questions that closely pertain to its scope of application should not remain open after its entry into force.

Backloading and reporting of exchange-traded derivatives add unnecessary burden

The requirement to backload trades has raised many questions. Backloading will cause expenses from the collection of data as well as from e.g. the acquisition of a LEI. The timeline from the regulation's entry into force to the beginning of the reporting obligation is so long that the volume of contracts is huge. Reporting has proceeded fairly well in practice, but because of the cost effect, we nevertheless suggest that similar undertakings are avoided in the future, or at least that the backloading requirements would only apply to contracts that are in force at the time. Such specification would not increase systemic risk. FFI believes that the reporting of intragroup derivative contracts does not have effect in terms of systemic risk, either, and that it would be sensible to remove the obligation to restrain the growing reporting costs.

The reporting of exchange-traded derivatives has been subject of much discussion throughout the legislative process. The requirement is difficult to find in the relevant regulation (which concerns OTC derivatives) and differs from the objective set at G20 level. In practice the reporting of exchange-traded derivatives has proceeded fairly well, and is usually outsourced. However, data must be collected from several separate sources, which causes additional administrative burden – and therefore costs – for the companies. Because many non-financial and small-in-size financial companies only use exchange-traded derivatives, removing the requirement would have spared them from the reporting and the acquisition of the LEI. Expansions such as this, which place European companies at an unfair disadvantage, should be avoided in the future.

The reporting process is incomplete while the markets are not

Based on the above, the total reporting process can be considered incomplete. What came somewhat as a surprise is that the largest reporting challenges are linked to the contracts made with large investment banks, whereas reporting with corporate and smaller counterparties goes without problems. Yet these easily reported contracts involve disproportionate reporting costs and an administrative burden, due to which many companies operate on very small resources entirely against regulatory requirements. It would therefore be extremely important to follow the principle of proportionality in the reporting obligations.

FFI will keep a close eye on the information published based on the reports, and the subsequent conclusions. It should be noted that the information may be disorganized due to the incompleteness of the reporting process. Majority of the issues are related only to the reporting techniques, and therefore the information should not be taken to reflect the market situation. Similarly, successful reporting of small transactions should not be treated as a signal of a well-directed wide reporting obligation, but rather as a sign that information on these contracts will not have a significant impact on the big picture.