European Fund and Asset Management Association

# EFAMA's Reply to ESMA's Consultation Paper on Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories (EMIR).

EFAMA is the representative association for the European investment management industry. EFAMA represents through its 27 member associations and 57 corporate members approximately EUR 14 trillion in assets under management of which EUR 8 trillion was managed by approximately 54,000 funds at the end of 2011.

Thank you for giving us the opportunity to submit evidence on the proposed Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories (EMIR).

EFAMA welcomes as very positive and fully supports the initiatives aimed at enhancing safety and transparency in the over-the-counter derivatives market.
Although we agree with many of the ESMA's guidelines, we wish to submit the following answers and comments to the consultation.

From EFAMA perspective, the key elements that will be developed through our answers are the following:

- There is no recognition of the agents/fund managers and other intermediaries acting for clients roles and responsibilities; and
- The only focus would seem to be on the position of CCPs. There should also be some reference to how long it will take counterparties to move to clearing of specific types of derivative; and
- The clearing house or CCPs foresee to impose higher haircuts/require further initial margin where a clearing member's credit rating slips below A. Client will be required to pay additional margin unless contracts can be transferred to another clearing member. What if a crisis and no clearing member used by a client has sufficient rating? What will be the effect on market for collateral? Haircuts and collateral, which are key elements, will rest on interpretation and model applied by CCP; and
- The reporting requirements should be met by trying as far as possible to use those which already exist.

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**Clearing Obligation (Article 3)**

**Contracts having a direct, substantial and foreseeable effect within the EU**

**Q1: In your views, how should ESMA specify contracts that are considered to have a direct, substantial and foreseeable effect within the EU?**

Under current drafting, the "direct, substantial and foreseeable effect" test is applied for contracts between third country entities.

EFAMA believes that the issue could arise under the EMIR and the Dodd Frank (DF) regime. The conclusion of an OTC derivative contract between the counterparties and the application of the appropriate regulation regime could be different from law used for the underlying asset.

Examples:

1. Single name CDS BMW; Plan Vanilla Interest Rate Swap: Underlying is in the scope of EMIR, counterparties of the OTC derivatives could be located in the EMIR region (e.g. Deutsche Bank) or outside the EMIR region (e.g. Goldman Sachs International; Affiliate of a US bank with UK law)
2. CD index contract of US CDS index: Underlyings refer to US underlyings. Counterparties of such OTC products could be in general US counterparties (e.g. US banks or Affiliates with a location in the EMIR region) or even counterparties located in the EMIR region.

Without further guidance on how to interpret this, a broad spectrum of activities can be caught under these phrases. Since most of our entities are located in jurisdictions subject to DF or EMIR - or similar regime in Asia - as well as the brokers, the key point for EFAMA is that EMIR/ESMA recognizes equivalent regimes, so that if for a trade is executed, cleared and reported under EMIR, there shouldn't be a need to adhere to DF as well.

We believe that this should be defined by reference to whether the contract and associated exposure is reflected on the balance sheet of an EU entity or brings about a major concentration of exposures in the EU.

As to the definition of "direct, substantial and foreseeable effect", we can think of a few parameters: (i) the application of a threshold (e.g. contracts with a particular notional amount or particular net value and duration and credit rating of counterparty), (ii) whether an equivalent clearing obligation applies in another jurisdiction, (iii) if no such clearing obligation applies, what is the jurisdiction asserting the final beneficiaries of such transaction.

**Q2: In your views, how should ESMA specify cases where it is necessary or appropriate to prevent the evasion of any provision of EMIR for contracts entered into between counterparties located in a third country?**

EFAMA believes that anti-evasion provisions of this nature are often hard to enforce, for example for transactions with European underlyings but with counterparties located outside Europe.
We would like to insist on the fact that investment managers have also a fiduciary obligation to provide best execution of their trades. If a firm enters into eligible contracts with a non EU entity rather than an EU entity for cost or compliance reasons, this should not be considered to be evasion.

In any case, a clear conflict procedure needs to be in place in order to have legal certainty for all market participants.

We also believe that affiliates of corporates located outside the European Union but with a business entity in Europe should not be in the scope of EMIR.

**Types of indirect clearing arrangements**

**Q3: In your views, what should be the characteristics of these indirect contractual arrangements?**

EFAMA have struggled on other occasions to understand what is an "indirect" clearing member, as in our view it is in fact a client. Where a bank, which is not a clearing member, offers to provide execution and clearing services to client, the bank will need to set up arrangements with a clearing member on behalf of the client. There should still be a direct contractual link between the clearing member and the client in order to ensure that the client's position at the clearing house is protected and the client is not exposed to the credit risk of the original bank and the clearing member.

In our view it is important to focus on the relationships between the client and clearing member and the clearing member and the clearing house to ensure that these are clearly drawn. In this respect, for example as mentioned in our general comments above, the discussion paper does not deal with the position of agents in the process, in particular fund managers.

EFAMA also believes that CCPs could not be able to provide individual segregated accounts in a sufficient number for the investment funds in time as that could hamper investment fund management companies from entering into OTC derivatives which are clearing eligible. We do not know whether or not ESMA will consider the CCPs ability to offer a sufficient number of individual segregated accounts before determining any class of OTC derivative as clearing eligible. Therefore we feel that there should an alternative to clear OTC derivatives which could not be cleared by a CCP due to the mentioned segregation requirements. In light of that, we would appreciate if ESMA could determine requirements for indirect contractual arrangements, which might be fulfilled by all market participants.

**<u>Clearing obligation procedure (Article 4)</u>**

**Q4: What are your views on the required information? Do you have specific recommendations of specific information useful for any of the criteria? Would you recommend considering other information?**

Subject to the comments below, we agree with the proposals of ESMA regarding the information required to assess the clearing obligation and the specifications for assessing standardization, volume, liquidity and availability of pricing information.
EFAMA do not feel that there is enough emphasis on the readiness of counterparties, and their agents, operationally, legally and from a risk perspective, to move from a bi-lateral environment to one of clearing for a certain type of contract.

We believe that ESMA should focus its work on a detailed description and definition of the relevant class of OTC derivatives determined by ESMA as clearing eligible. We think that a detailed definition of the relevant class of clearing eligible OTC derivative will enhance legal certainty to all market participants. We think that ESMA should obtain all information which is relevant if CCPs offer clearing for a class of OTC derivatives. The relevant information should also be provided to the market participants (e.g. investment fund management companies) and should include at least information on the level of segregation, e.g. a detailed description on individual segregated accounts.

We think that all relevant information obtained by ESMA to fulfill their duties of the clearing obligation procedure should only be used for these purposes. We believe that the national competent authority or ESMA should not be allowed to publish individual information on OTC contracts, positions etc. for counterparties as this could reveal investment strategies used by investment fund managers.

We finally estimate that investment fund management companies, managing numerous investment funds established in accordance with contract law (cf. Art. 1 para. 3 of Directive 2009/65/EC), may be requested by their national supervisory authority to adopt stricter rule such as segregate assets belonging to different investment funds by way of individual segregation. Without a clarification by ESMA that a segregation of the assets of different investment funds can also take place via omnibus accounts, some investment funds are already discriminated because individual segregation seems to be more expensive than omnibus segregation.

We think that ESMA either has to clarify that it is sufficient that an omnibus segregation fulfills the requirements under Article 8 para. 1 of the Directive 2010/43/EC, or it shall ensure that it will only determine a class of OTC Derivatives as clearing eligible if the relevant CCP is able to provide a sufficient number of individual segregated accounts in time.

Therefore, as there should be equal treatment whatever the route to market, we expect ESMA to conduct a public consultation prior to any draft RTS being published, whether following a notification from a competent authority or where ESMA is using its own initiative. The conduct of the public consultation and timeframes should also be clarified and must allow sufficient for responses to every actor in the Market, including national and international industry representatives which need to consult with their members.

**Q5: For a reasonable assessment by ESMA on the basis of the information provided in the notification, what period of time should historical data cover?**

EFAMA think that ESMA should use historical data in its assessment as much as possible.

We believe that a main factor might be the volume of an OTC instrument. One approach could be that ESMA might for example give greater weight to more recent data given the rapid and significant market and technological developments.

**Q6: What are your views on the review process following a negative assessment?**

EFAMA supports in principle the review process. However, we believe that the principal framework of a negative assessment of the eligibility for the clearing obligation should be clearly defined, e.g. one parameter might be the potential volume of the specific OTC transaction.

We also believe that, to the extent that an application is re-considered following a re-submission, the new application should be treated as a new submission and the entire review process should start again, including a public consultation.

**<u>Criteria to be assessed by ESMA under the clearing obligation procedure</u>**

**Q7: What are your views regarding the specifications for assessing standardisation, volume and liquidity, and availability of pricing information?**

EFAMA believes that standardization should be assessed by reference specifically to clients' and their agents' legal and operational readiness, as well as that of clearing members and CCPs. Many clients will not have sophisticated execution, processing and settlement systems for dealing with OTC derivatives transactions and will in fact often rely on agents – investment managers, brokers and other intermediaries – to perform these services for them. It is crucial that the position of clients and where relevant their agents is taken into account.

We have particular concerns regarding the front loading provisions and the fact that the phase-in of clearing of front loaded contracts has not been dealt with. Given that the clearing obligation under EMIR Article 3(1)(b)(ii) may take effect in respect of certain classes of contract before ESMA has determined that that class should be subject to the clearing obligation, and before any RTS have been finalized dealing with the minimum remaining maturity and any phase-in. There needs to be some consideration of how this provision will work in practice. Otherwise there is likely to be confusion and uncertainty in the market.

We also believe that the kind of product related provisions applicable to the specific OTC derivatives should be taken into account in the assessment. Market participants agree on product related provisions, such as the so-called ISDA Equity Derivatives Definitions or the Annex for Equity Derivatives Transactions issued by the Association of German Banks. As mentioned, market participants use different master agreements as the language of the documentation and the governing laws (e.g. why should two market participants both located in Germany or in France agree on derivatives in English subject to UK or even US laws?) are different.

**Public register available on ESMA website**

**Q8: What are your views, regarding the details to be included in ESMA register of classes of derivatives subject to the clearing obligation?**

EFAMA believes that subject to the comments set out below the details are sufficient and supports the identification of the CCPs, especially the usage of the LEI. We believe that ESMA should also determine the type of legal documentation (definitions) in the public register.

It is important that all the information is clearly understood. However, we note that some parts of the information are still not clear such as the distinction between “class of OTC derivatives” which is defined in EMIR and what is to be described by the criteria set out in paragraph 24, and “general class of derivatives” which is one of the criteria used to describe the “class of OTC derivatives”. In addition, what is the difference between the “general class of derivatives” and the “type of derivative contracts”? This could be remedied, for example, by an explanation after each criteria, or explanatory note, setting out what sort of information it is intended to cover: e.g. general class of derivatives – general type of underlying - interest rates, equity, equity index, bond etc. , and type of derivative contract – swap, option (put or call), forward, future etc.

The details on each class of OTC derivative contract should also specify the CCPs where the contracts are cleared and the exchanges and venues where they can be traded and whether they are subject to the obligation to execute on a trading venue.

For CCPs, the information should specify the full LEGAL name of the CCP and also set out the classes of OTC derivatives which can be cleared via that CCP.

Para 26 should make it clear that the information is provided in respect of each class of OTC derivatives.

**Q9: Do you consider that the data above sufficiently identify a class of derivatives subject to the clearing obligation and the CCPs authorised or recognised to clear the classes of derivatives subject to the clearing obligation?**

EFAMA estimates that the data mentioned above are overall sufficient, subject to the points mentioned in Q4 and Q8.

**Non-financial counterparties (Article 5/7)**

**Criteria for establishing which derivative contracts are objectively measurable as reducing risk directly related to the commercial activity or treasury financing**

**Q10: In your view, does the above definition appropriately capture the derivative contracts that are objectively measurable as reducing risk directly related to the commercial or treasury financing activity?**

No comment

**Clearing Threshold**

**Q11: In your views, do the above considerations allow an appropriate setting of the clearing threshold or should other criteria be considered? In particular, do you agree that the broad definition of the activity directly reducing commercial risks or treasury financing activity balances a clearing threshold set at a low level?**

No comment

**Risk mitigation for non-CCP cleared contracts (Article 6/8)**

EFAMA has a general comment on this section.

Whilst we tend to agree with the general nature of the risk mitigation processes proposed in the discussion paper for non-CCP cleared contracts, we are concerned that the proposals do not take account of the different types of participants, their different use of OTC derivatives and their different natures and relationships.

Indeed, the discussion paper makes only the distinction between financial and non-financial counterparties and where a certain threshold is met.

**Q12: What are your views regarding the timing for the confirmation and the differentiating criteria? Is a transaction that is electronically executed, electronically processed or electronically confirmed generally able to be confirmed more quickly than one that is not?**

EFAMA acknowledges that an electronic trade will be confirmed faster. We agree that timely confirmation of transactions is always a risk mitigant.

However we do not think a unique and immediate timing is possible or beneficial.

Indeed there are:

- technical constraints (like systems that run on batches instead of real time) that cannot be solved or at least not without tremendous efforts and massive costs that will be supported at least partly by investors; and
- different confirmation process per instruments among other criteria; and
- different degrees of automation already available; and
- increased amount of "failed trades" or "trades cancellation" as time frame of 30 minutes does not leave any reserves to resolve possible discrepancies in the confirmation process between the counterparties, and even less in a time frame of 15 minutes; and
- significant increases in costs for many clients as there will be major infrastructures development to do to meet these standards.

We also believe that some aspects of the discussion paper are unclear:

- should both sides to the transaction be required to confirm? Should both sides "draft and match" their confirmations? In previous model, ("client model"), the broker or the counterparty used to produce the confirmation and the client had time to approve or modify it; and
- the distinction between financial and non-financial counterparties is unclear (as said before) and creates confusion on the timeframe to apply e.g. if one party is a financial counterparty and the other counterparty is a non-financial

Even in a fully STP environment using automated trade matching, the time frames proposed under paragraphs 38a and b are unrealistic.

**Q13: What period of time should we consider for reporting unconfirmed OTC derivatives to the competent authorities?**

EFAMA is of the opinion that every transaction should be confirmed as soon as practically possible and that unconfirmed trades should be reported to a competent authority within reasonable time frame.

We however believe, as said in the general comments that a distinction must be made between the counterparties which are clients and those which are not clients. We don't think that those requirements should apply to clients of financial counterparties.

**<u>Marking-to-market and marking-to-model</u>**

**Q14: In your views, is the definition of market conditions preventing marking-to market complete? How should European accounting rules be used for this purpose?**

EFAMA believes that some definitions should be given like “inactive market” (e.g. no price or turnover for the past two days) or “mark-to-model” (to also incorporate to the definition the use the internal models and external pricing sources for valuation purposes against prices given by their counterparties).

This section also assumes that the counterparties will either mark-to-market or mark-to-model depending on market conditions but this does not take into account that marking-to-model approach will use market data in the model on for example the underlying, historic prices and other similar products.

**Q15: Do you think additional criteria for marking-to-model should be added?**

EFAMA restates that, as mentioned above, all models will need to use market data of some sort. The criteria should make it clear that mark-to-market information should be used in the model as far as possible.

**<u>Reconciliation of non-cleared OTC derivative contracts</u>**

**Q16: What are your views regarding the frequency of the reconciliation? What should be the size of the portfolio for each reconciliation frequency?**

EFAMA agrees that it is sensible to conduct regular reconciliations of non-cleared contracts, as it is important to ensure that counterparties have a clear understanding of their positions, even where there are no systemic issues.

However, we believe that the arrangements envisaged by ESMA could be too limited.

- they do not take the position of counterparties using fund managers and other agents to execute their trades into account; and
- if an investment fund management company managing investment funds established in accordance with contract law has to consider 300 contracts total for all funds, it would be a discrimination since each investment fund constituted in accordance with statute could consider up to 300 contracts without sharing this volume with any further investment funds.

We believe that the proposed threshold of 300 or more OTC derivatives suggested by ESMA needs to be amended. We are of the opinion that the range of reconciliation should be calibrated as follows:

- Each business day: 500 or more OTC derivatives for the counterparties
- Weekly: 251- 499 OTC derivatives for the counterparties
- Quarterly: < 250 OTC derivatives for the counterparties

We feel that investment fund management companies using bilateral collateral management should be able to reconcile their position on a daily basis.

We also believe that immediate action should recommended by ESMA in case of a big difference in the mark-to-market valuation.

**Portfolio compression**

**Q17: What are your views regarding the threshold to mandate portfolio compression and the frequency for performing portfolio compression?**

EFAMA believes that, despite we think that portfolio compression is a positive idea, we have doubts over its relevance to many market participants.

The clients of many investment managers will have OTC derivatives for hedging risks in one direction. We believe, therefore, that instead of, or a as well as considering a threshold approach, ESMA should consider the type of counterparty and the nature of the positions that they are holding.

In addition, these proposals ignore the fact that a client's portfolio may be fragmented across a number of agents/fund managers, so it is not always going to be a realistic option in practice.

**Dispute resolution**

EFAMA has a general comment for this section.
We assume these questions refer to both cleared and non cleared contracts.

Dispute Resolution mechanisms are already broadly used (e.g. under a Credit Support Annex of the ISDA Master Agreement). In our view, dispute could incorporate some of the commonly used practice to set up guidelines.

The application of thresholds to report a dispute to the competent authority should be further clarified by specifying who has the obligation to report such dispute. The existence of such a dispute should not become a public information.

**Q18: What are your views regarding the procedure counterparties shall have in place for resolving disputes?**

EFAMA supports the idea made by ESMA that the financial counterparties should have in place a dispute resolution framework. The introduction of a dispute resolution framework will enhance the legal certainty for all market participants and improve the protection of investors. However, we believe that any dispute should be solved on the following business day at the latest. Otherwise it could create a problem in the valuation and reconciliation process.

**Q19: Do you consider that legal settlement, third party arbitration and/or a market polling mechanism are sufficient to manage disputes?**

EFAMA agrees with the proposal as any dispute should be solved as soon as possible.
Please note however that legal settlement cannot be considered as a mechanism for managing dispute but rather a way to record and implement agreements executed between counterparties.

**Q20: What are your views regarding the thresholds to report a dispute to the competent authority?**

EFAMA agrees with this principle.
It is a good idea to report dispute for significant amount as it would ensure to inform of exposures that would not be not reflected on balance sheets of banks or counterparties.

The threshold proposed by ESMA is in line with that proposed in the USA (US$20m). EFMA note that, the average amount disputed seems to be a fraction of the proposed threshold amounts.

**<u>Intra-group exemptions</u>**
**Q21: In your views, what are the details of the intragroup transactions that should be included in the notifications to the competent authority?**

No comment

**Q22: In your views what details of the intragroup transactions should be included in the information to be publicly disclosed by counterparty of exempted intragroup transactions?**

EFAMA believes that ESMA should consider that the details of the exempted intragroup transactions should only be published if one of the parties is a non-financial counterparty (cf. Article 8 para. 1n (c) EMIR).

From our point of view, the requirement laid down in Article 8 EMIR does not mean any obligation to publicly disclose any details of the transactions subject to the exemption.

**<u>III.II CCP Requirements</u>**

**<u>Access to a venue of execution (Article 8a)</u>**
**Q23: What are your views on the notion of liquidity fragmentation?**

EFAMA could not retrieve any article 8a in the version of the text we have, but we assume that the reference should in fact be to article 5a., We are concerned that a requirement to consider liquidity fragmentation may have an adverse effect on choice, if it is too narrowly drawn. We are concerned that any provisions preventing access to a CCP by a venue of execution may lead to concentration of clearing in a handful of CCPs and execution in a small number of venues.

On the one hand, clearing all trades through the same counterparty will realise the maximum amount of cross-margining and result in the most efficient use of posted collateral. As a counter example, a large number of localised CCPs will also increase costs to the end investor. If a CCP has to be legally incorporated in a particular country to clear that currency, for example, global derivative users will be forced to split their trades among multiple venues. This would greatly reduce netting efficiencies.

On the other hand, this efficiency would be offset by the significantly higher fees and costs that such a monopolistic CCP would be able to charge. This would in turn reduce portfolio returns for the end investor and ultimately lead to lower pensions and savings for European citizens.
Interoperability cannot be relied upon to resolve such problems.

The concept of access to execution venues by CCPs and to CCPs by execution venues is also picked up in the draft MiFID 2 text where liquidity fragmentation is not mentioned as a factor. It is therefore important that any RTS do not cut across the position promoted under MiFID II.

**Recognition of a CCP (Article 23)**
**Organisational Requirements (Article 24)**
**Q24: What are your views on the possible requirements that CCP governance arrangements should specify? In particular, what is your view on the need to clearly name a chief risk officer, a chief technology officer and a chief compliance officer?**

Generally these seem sensible and would appear to follow the IOSCO provisions. However, we think there should be more emphasis placed on conflicts of interest – see answer to question 25 below.

**Q25: Are potential conflicts of interests inherent to the organisation of CCPs appropriately addressed?**

We consider that there should be more of an emphasis on the management of conflicts especially with respect to those inherent in the ownership structures of CCPs. In our view, there should be full disclosure of the governance rules at the CCP as one would expect full transparency.

In addition we believe that there should be an explicit requirement for CCPs to notify their competent authorities of any conflicts of interest and the ways in which these are managed.

We are pleased to note, however, that the latest version of EMIR that we have sight of that provides for representatives of clients to attend the risk committee meetings of CCPs in a voting capacity, and that no one group of representatives on that committee will have a majority. This is a positive step towards managing conflicts of interest from the perspective of clients.

**Q26: Do the reporting lines – as required – appropriately complement the organisation of the CCP so as to promote its sound and prudent management?**

No comment

**Q27: Do the criteria to be applied in the CCP remuneration policy promote sound and prudent risk management? Which additional criteria should be applied, in particular for risk managers, senior management and board members?**

No comment

**Q28: What are your views on the possible organisational requirements described above? What are the potential costs involved for implementing such requirements?**

No comment

**Q29: Should a principle of full disclosure to the public of all information necessary to be able to understand whether and how the CCP meets its legal obligations be included in the RTS? If yes, which should be the exceptions of such disclosure requirements? Has the information CCP should disclose to clearing members been appropriately identified? Should clients, when known by the CCP, receive the same level of information?**

Apart from the below comment, EFAMA agrees with the proposal.

In EFAMA views, clients (and their representatives and agents) should receive the same level of information as clearing members, whether or not “known” to the CCP, as ultimately it is their assets and positions that are at risk/being cleared.

The client of the clearing broker is beneficial owner of the collateral posted however it does not have a direct contractual relationship with the CCP. Transparency is key to mitigate the risk that key information becomes known to the client late in the game simply because the client’s clearing broker is in between both.

Information should be available to all clients, whether or not known to the CCP, to enable them to assess the protection provided by each CCP. Where clients are not clearly identifiable to the CCP, we believe that CCPs should ensure that information is passed on to clients by clearing members, and clearing members should be required to pass on the information to clients in a timely manner.

Consequently, to ensure prudent risk management, both for the CCP and Clearing Members (directly or indirectly), those agreements should be organized and their execution disclosed.

**Record keeping (Article 27)**

**Q30: What are your views on the possible records CCPs might be required to maintain?**

EFMA believes that these requirements might prove to be sensible as

- it is unclear how pre-clearing amendments to contracts and transfers and novations will be dealt with; and
- the CCP should at any time know the clearing members and their clients; and
- the knowledge of the identity of each client is required in order to fulfill proper level of segregation and portability requirements.

**Q31: What are your view on the modality for maintaining and making available the above records? How does the modality of maintaining and making available the records impact the costs of record keeping?**

EFAMA is concerned with the absence of any proposals dealing with access to transaction records by clients and counterparties generally.

**Business continuity (Article 32)**

**Q32: What are your views on the possible requirements for the business continuity and disaster recovery plan and in particular on the requirements for the secondary site? Would it be appropriate to mandate the establishment of a third processing site, at least when the conditions described above apply? What are the potential costs and time necessary for the establishment of a third processing site and for immediate access to a secondary business site?**

No comment

**Q33: Is the 2 hours maximum recovery time for critical functions a proportionate requirement? What are the potential costs associated with that requirement?**

No comment

**<u>Margins (Article 39)</u>**

**Q34: Are the criteria outlined above appropriate to ensure that the adequate percentage above 99 per cent is applied in CCP's margin models? Should a criteria based approach be complemented by an approach based on fixed percentages? If so, which percentages should be mandated and for which instruments?**

EFAMA believes that the confidence interval should be made mandatory for all financial instruments and not be applied on a criteria based approach. This would enable the market participants to a compare different CCPs margin models.

**Q35: Taking into account both the avoidance of procyclicality effects and the need to ensure a balance distribution of the financial resources at the CCP disposal, what it is in your view the preferred option for the calculation of the lookback period.**

EFAMA preferred option is the option c.

**Q36: Is in your view the approach described above for the calculation of the liquidation period the appropriate one? Should a table with the exact number of days be included in the technical standards? Should other criteria for determining the liquidation period be considered?**

EFAMA believes that the determination of the liquidation period should be harmonized and made mandatory in order to have a high comparability between the CCPs which offer clearing services for the same OTC product.

**Q37: Is procyclicality duly taken into account in the definition of the margin requirements?**

We are of the opinion that procyclicality should be avoided if the definition of the margin requirements includes parameter stress market conditions.

We believe that CCPs should proactively monitor market trends and risks. Based on relevant risk models and infrastructures it would be in a position to assess if there is any need to increase margin to address future expected market fluctuations.  Margin set at a 99% percent confidence level over a period that may include a stress market condition period is already likely to be sufficiently robust and able to withstand cyclical changes.

**Q38: What is your view of the elements to be included in the framework for the definition of extreme but plausible market conditions?**

We think that the most important scenario for a CCP is the systemic risk involving a global financial crisis with a domino effect.

**Liquidity risk controls (Article 41a)**

**Q39: Do you believe that the elements outlined above would rightly outline the framework for managing CCPs' liquidity risk?**

No comment

**Q40: Do you consider that the liquid financial resources have been rightly identified? Should ESMA consider other type of assets, such as time deposits or money market funds? If so, please provide evidences of their liquidity and minimum market and credit risk.**

EFAMA opinion is that diversification and effect on liquidity, especially in periods of market stress, should be taken into account by ESMA.

Diversification is a key risk mitigation tool but in times of stress market, the liquidity is severally reduced; some assets are becoming less liquid and others become much more liquid.

We also believe that CCPs should have access to central bank liquidity as they might be exposed to systemic risk in case of default of one or several clearing members.

**Q41: Should the CCP maintain a minimum amount of liquid assets in cash? If so, how this minimum should be calculated?**

EFAMA believes that CCPs should maintain a minimum amount of liquid assets in cash to enable intraday activity. This minimum could be calculated based on VaR analysis on outstanding net exposure of the contracts.

**Default waterfall (Article 42)**

**Q42: What is your preferred option for the determination of the quantum of dedicated own resources of CCPs in the default waterfall? What is the appropriate percentage for the chosen option? Should in option a, the margins or the default fund have a different weight, if so how? Should different criteria or a combination of the above criteria be considered?**

No comment

**Q43: What should be the appropriate frequency of calculation and adaptation of the skin in the game?**

No comment

**Collateral requirements (Article 43)**

**Q44: Do you consider that financial instruments which are highly liquid have been rightly identified? Should ESMA consider other elements in defining highly liquid collateral in respect of cash of financial instruments? Do you consider that the bank guarantees or gold which is highly liquid has been rightly identified? Should ESMA consider other elements in defining highly liquid collateral in respect of bank guarantees or gold?**

EFAMA believes, as stated in Q40, that diversification and its impacts, should be cautiously considered.

We believe that the scope of highly liquid financial instruments as collateral accepted by a CCP also has to include government bonds and equities.

CCPs should also limit have strict issuers limits over the amount of collateral received which relates to owners of the CCP.

We believe that some guidance should be given on what is meant by “low risk” to ensure that this is not interpreted too diversely across CCPs.

We would also urge ESMA to make it clear that cash collateral where it is transferred to the CCP will be subject to the CCP’s investment policy and liquidity provisions and the proposed requirements in respect of cash set out in para 120(1) of the discussion paper relate to cash accounts which are the subject of a charge in favour of the CCP rather than an outright transfer.

Real estate investment funds will also face problems in order to hedge their existing currency risks via OTC derivatives if those are determined to be clearing eligible. Real estate investment funds are obliged to be invested in real estate and have to maintain liquidity for the redemption of fund units. Therefore real estate investment funds might not be able to provide highly liquid financial instruments as collateral to a CCP. We believe that in such circumstances a real estate investment fund should, additionally to bonds, be allowed to provide a bank guarantee as collateral (such possibility should not be limited to non-financial clearing members but also offered to clients).

**Q45: In respect of the proposed criteria regarding a CCP not accepting as collateral financial instruments issued by the clearing member seeking to lodge those financial instruments, is it appropriate to accept covered bonds as collateral issued by the clearing member?**

Our preference would be to limit as far as possible collateral issued by clearing members of owners of the CCP. Accepting Covered Bonds depends on the correlation of the coverage with the CCP exposures and they must have to be easily without a significant decrease in value and without any delay. In case of a high correlation, the covered bond should not be allowed.

**Q46: Do you consider that the proposed criteria regarding the currency of cash, financial instruments or bank guarantees accepted by a CCP have been rightly identified in the context of defining highly liquid collateral? Should ESMA consider other elements in defining the currency of cash, financial instruments or bank guarantees accepted by a CCP as collateral? Please justify your answer.**

Please see our answers to Q44 and Q45.

We believe that further thought needs to be given to Euro denominated financial instruments, which will not necessarily be highly liquid. ESMA should also consider what would happen should a country leave or integrate the Euro.

**Q47: Do you consider that the elements outlined above would rightly outline the framework for determining haircuts? Should ESMA consider other elements?**

EFAMA believes that the elements outlined are on the whole sensible, subject to our comments below.

ESMA states that haircuts should be sufficiently prudent so that collateral can be liquidated without significant market impact. This seems to be illogical. The amount of collateral held does not relate to the market impact in liquidating that collateral. Market impact will relate to the amount of collateral being sold at any one time and the price sensitivity of the particular instruments.
Haircuts should not operate in a procyclical way in that they should not increase during times of market volatility or stress.

Section 127 of the paper mentions that "margins should be calculated in a conservative manner". Applying conservative haircuts to securities collateral might adversely impact investment funds. UCITS are typically long only investing and therefore have very limited collateral netting opportunities across their positions. In case conservative haircuts are applied to collateral posted to CCPs, this would potentially increase the amount of collateral a fund will have to post to CCP therefore impacting the fund's liquidity.

We therefore recommend applying different haircut methodologies depending on the type of end Client's the CCP will deal with. Moreover, arbitrary additional conservative haircuts do not only lead to potential penalization, they might also lead to market arbitrage processes according to Clearing Members preferences.

**Q48: Do you believe that the elements outlined above would rightly outline the framework for assessing the adequacy of its haircuts? Should ESMA consider other elements?**

EFAMA is of the opinion that ESMA should not only consider these elements on only the collateral but also on the contracts. Price volatility could also have impact on the adequacy of the haircuts and margin levels.

**Q49: Do you consider that the elements outlined above would rightly outline the framework for determining concentration limits? Should ESMA consider other elements?**

EFAMA agrees to the proposed framework.

**Q50: Should a CCP require that a minimum percentage of collateral received from a clearing member is provided in the form of cash? If yes, what factors should ESMA take into account in defining that minimum percentage? What would be the potential costs of that requirement?**

EFAMA believes that CCP might have to require a minimum percentage of cash to be able to meet the intraday flows (see also Q41). The potential cost will be the cost of funding for the CCP (against, we assume, a lower margin / haircut resulting in a lower counterparty (CCP) risk for the clearing member).

There should however be different treatment by client type.
Funds, and especially UCITS, will typically access CCP clearing via clearing members.
If clearing members are required to post a minimum percentage of collateral in the form of cash, those obligations will be passed on to the clearing member’s clients, including UCITS.

Many are fully invested and have a structurally low amount of cash at their disposal. The obligation to post cash collateral at CCPs instead of securities would impact their investment capability which represent the core activity of these vehicles. This measure will potentially reduce the fund's investment capabilities to post collateral resulting in lower returns – and hence savings and pensions – for European citizens.

If UCITS are required to post cash as collateral to their clearing brokers, one of the options they have is to use repurchase (“repo”) transactions which in turn will impact the costs supported by end investors.

**Investment policy (Article 44)**

**Q51: Do you consider that financial instruments and cash equivalent financial instruments which are highly liquid with minimal market and credit risk have been rightly identified? Should ESMA consider other elements in defining highly liquid financial instruments with minimal market and credit risk? What should be the timeframe for the maximum average duration of debt instrument investments?**

EFAMA restates that, as mentioned above, liquidity should also be considered in the context of diversification of assets and the effect on liquidity in periods of market stress.

We however believe that the financial instruments are rightly identified. ESMA could consider instruments less guaranteed but high quality collateralized (e.g. repo or reversed repo). The maximum average duration should depend on market conditions.

**Q52: Do you think there should be limits on the amount of cash placed on an unsecured basis?**

EFAMA believes in the need of a limit on unsecured cash although ESMA should also consider Money Market Funds.

**Q53: Do you consider that CCP should be allowed to invest in derivatives for hedging purposes? If so, under which conditions and limitations.**

EFAMA preference would be for CCPs not to be allowed to invest in derivatives or only for hedging purposes.

**Q54: Do you consider that the proposed criteria regarding the currency of financial instruments in which a CCP invests has been rightly identified in the context of defining highly liquid financial instruments with minimal market and credit risk? Should ESMA consider other elements in defining the currency of highly liquid financial instruments with minimal market and credit risk? Please justify your answer.**

Please see our response to question 46.

ESMA could also consider currencies of contract exposures as acceptable.

**Q55: Do you consider that the elements outlined above would rightly outline the framework for determining the highly secured arrangements in respect of which financial instruments lodged by clearing members should be deposited? Should ESMA consider other elements? Please justify your answer.**

The criteria in paragraph 140 of the Discussion Paper set an interesting baseground for the protection of assets deposited as collateral.

Paragraph 140 does not, however, deal with the issues of rehypothecation possibilities.

**Q56: Do you consider that the elements outlined above would rightly outline the appropriate framework for determining concentration limits? Should ESMA consider other elements? Please justify your answer.**

EFAMA believes that is a correct framework.

ESMA could also consider the correlation between the investments made and other exposures.

**Review of models, stress testing and back testing (Article 46)**

**Q57: What are your views on the definitions of back and stress testing?**

No comment

**Model Validation:**

**Q58: What are your views on the possible requirements for a CCP's validation process?**

Due to the increased legal and operational standardization of OTC products, we think that CCPs have to use models to assess the validity and the adequacy of its risk management model which are authorized by the regulators. The regulators should be capable to validate the models used by the CCPs in order to fulfill their supervisory functions.

**Back tests:**

**Q59: What are your views on the possible back testing requirements?**

Please see our answer to question 58.

**Q60: Would it be appropriate to mandate the disclosure of back testing results and analysis to clients if they request to see such information?**

We believe that it is appropriate to require the disclosure of these results to clients (and their representatives or agents). If the central counterparty uses its own model validation, the back testing results should be disclosed to the public.

It is important that there is as much transparency over the collateral process and the validation and testing of the process as possible, for clients who, at the end of the day, are the ones exposed and responsible for providing collateral.

It is important that clients understand the cost and risks of posting their collateral at each CCP so that they can compare.

**Q61: Should the time horizons for back tests specified under 144(e) be more granular? If so, what should the minimum time horizon be? Should this be different for different classes of financial instruments?**

No comment

**Stress tests:**

**Q62: What are your views on the possible stress testing requirements?**

EFAMA believes that the stress test requirements used by the CCPs should be authorized by the regulators.

**Q63: Would it be appropriate to mandate the disclosure of stress testing results and analysis to clients if they request to see such information?**

Please see our answer to Q60.

**Q64: What are your views on the possible requirements for reverse stress tests? And what impact do you think such requirements would have on industry?**

EFAMA believes that, if the stress testing model is approved by the regulators, a reverse stress testing model is not necessary and that costs related to its development would impact to a large extend the investors.

**Testing results:**

**Q65: Should there be any other parties involved in the definition and review of tests? Please justify your answer and explain the extent to which suggested parties should be involved?**

EFAMA agrees with ESMA´s position that the Risk Committee provides for appropriate representation of clearing members and clients (e.g. investment fund management companies).

**Testing of default procedures:**

**Q66: Should the testing of default procedures involve a simulation process?**

No comment

**Frequencies of tests:**

**Q67: Are the frequencies specified above appropriate? If no, please justify your answer.**

No comment

**Information to be publicly disclosed:**

**Q68: In your view what key information regarding CCP risk management models and assumptions adopted to perform stress tests should be publicly disclosed?**

No comment

## III.III Trade Repositories

**Reporting obligation (Article 6/7)**

EFAMA has a couple of general comments of this entire section:

- reporting is not the answer to all supervision problems. It should be a tool to monitor systemic risk and identify possible instances of market abuse; and
- reporting to monitor individual counterparties is too farfetched. It would have a profound effect on market mechanics as the risk is that regulators will get involved in the investment process.

**Q69: What is your view on the need to ensure consistency between different transaction reporting mechanisms and the best ways to address it, having in mind any specific items to be reported where particular challenges could be anticipated?**

EFAMA welcomes ESMA´s proposal that the double reporting of OTC derivative transactions under the intended MiFID transaction reporting regime and the proposed reporting requirements to trade repositories under EMIR will be avoided.

We think that ESMA should rather define who the reporting entity is in a given transaction, depending on the categories of counterparties involved in such transaction. In the case of investment funds (and even more for UCITS), we think that the reporting duty should always be fulfilled by the investment bank and we therefore recommend to state that when the transaction is executed between a fund and such investment bank the reporting entity should be in priority the investment bank or broker who is making the market.

The fact that the obligation under EMIR attaches at the level of the counterparty should make it clear that it does not apply to any agent or intermediary acting on behalf of counterparty in the transaction process.

EFAMA also believes that consistency and clarity are key elements to efficiency of the market. ESMA should ensure that its reporting requirements for OTC derivatives are consistent with other reporting requirements, existing or currently under discussion and (i.e. MiFID II), both within the EU and overseas.

ESMA should ensure that the scope and application of the obligation is as clear as possible so that there is little room for different interpretations across Member States. The fact that the obligation under EMIR attaches at the level of the counterparty should make it clear that it does not apply to any agent or intermediary acting on behalf of a counterparty in the transaction process.
The proposals in the discussion paper also lacks the clarity on how reporting can be delegated to a third party, or can be deemed to have been complied with due to reporting from another source – e.g. a clearing member, CCP, or the other counterparty.

In general, we propose that the clients of fund managers should be able to rely on the transaction reports made by their clearing member/broker with whom the trade is executed and/or cleared. We understand that it is not ESMA’s intention to restrict the ability of a counterparty to delegate transaction reporting but that the regulatory obligation will remain with each counterparty.

We believe that the level of detail required to be reported is onerous and goes far further than transaction reporting requirements in other market sectors and covers far more than those elements needed to confirm a trade or enable regulators to monitor systemic risk and identify market abuse. Such detailed reporting will inevitably require participants to undertake substantial systems up-grades.

**Q70: Are the possible fields included in the attached table, under Parties to the Contract, sufficient to accurately identify counterparties for the purposes listed above? What other fields or formats could be considered?**

Please see our answer to question 69.

EFAMA however thinks the fields listed in the Annex are sufficient. In this context our members specifically support the use of globally accepted identifiers for all trades/counterparties in all reporting. The required identifiers should be available on a license and fee free basis. Primarily ISO standards should be considered for this purpose.

We support also the introduction of developing and implementing a system of LEIs.
We believe that the recommendations will enhance the transparency of information to relevant authorities and the public and will therefore improve financial stability.

**Beneficiaries**

**Q71: How should beneficiaries be identified for the purpose of reporting to a TR, notably in the case of long chains of beneficiaries?**

We think that the identification of beneficiaries by non natural person should be made by the LEI.

For collective investment funds set up for multiple investors, the obligation to report the identity of the beneficiary should stop at the level of the fund/sub-fund (where liability is segregated at a sub-fund level). Investors in UCITS hold shares that represent their participation in the fund. UCITS can usually identify who their investors are at any point in time using the fund's register (unless global certificates or bearer shares have been issued).

In the case of pension funds this should also be the at the fund level.

Insurance funds set up by insurance companies part of the insurers balance sheet and so should be reported at the insurance company level.

**Coding**

**Q72: What are the main challenges and possible solutions associated to counterparty codes? Do you consider that a better identifier than a client code could be used for the purpose of identifying individuals?**

EFAMA supports the work being done by the FSB and the ISO to develop a new global legal entity identification (ISO 17442) and believe that ESMA should adopt that standard when approved.

As for identifying individuals, we suggest that the tax identification number for individuals (eg. NI Number in the UK), prefixed by the 2-character ISP country code (ISO 3166) be used or on the basis of tax, social security or passport number. ESMA should agree on the identifiers applicable to the country.

**Q73: What taxonomy and codes should be used for identifying derivatives products when reporting to TRs, particularly as regards commodities or other assets for which ISIN cannot be**

**used? In which circumstances should baskets be flagged as such, or should their composition be identified as well and how? Is there any particular aspect to be considered as regards a possible UPI?**

EFAMA proposes to use the details on the transactions.

**Trade Identification**

**Q74: How complex would be for counterparties to agree on a trade ID to be communicated to the TR for bilaterally executed transactions? If such a procedure is unfeasible, what would the best solution be to generate the trade ID?**

We believe that trade IDs for transactions involving clients should be allocated by the bank or broker which is a counterparty to the transaction.
Another option could be to use ID's used in existing platforms like Markitwire and DTCC.

**Pricing and fees**

**Q75: Would information about fees incorporated into pricing of trades be feasible to extract, in your view?**

We don't agree with this proposal because of the many different ways of calculating fees. Transactions can be outstanding for more than 10 years and fee discovery can be difficult in such cases.

We believe that it should be, and that any obligation to report should fall on the party to the transaction which is raising the fee.

**Risk mitigation and clearing**

**Q76: What is your view of the granularity level of the information to be requested under these fields and in particular the format as suggested in the attached table?**

Please see our general comments for this section above and the response to question 69.
We consider the granularity level too high.

There are two elements that could be more clearly defined, for example as follows:

e. if the trade is not to subject to clearing, the reason (including any intra-group or other exemption);

f. if the trade is subject to clearing, the date of novation and to which CCP

**Specific asset classes**

**Q77: Are the elements in the attached table appropriate in number and scope for each of these classes? Would there be any additional class-specific elements that should be considered, particularly as regards credit, equity and commodity derivatives? As regards format, comments are welcome on the possible codes listed in the table.**

We consider them appropriate for each class of derivative and think the reporting details should be kept as harmonised as possible. The key element is that the 'underlying' is part of the reporting for each type of derivative.

**Additional points**

**Data on exposures**

**Q78: Given that daily mark-to-market valuations are required to be calculated by counterparties under [Article 6/8] of EMIR, how complex would it be to report data on exposures and how could this be made possible, particularly in the case of bilateral trades, and in which implementation timeline? Would the same arguments also apply to the reporting of collateral?**

As mentioned under our general comments to this section and in response to question 69, we do not think that trade reporting should or can easily be used to monitor counterparty exposures, particularly in respect of non-cleared trades where each counterparty may use a different methodology and price information to calculate exposures.

**Reporting by third parties**

**Q79: Do you agree with this proposed approach? What are in your view the main challenges in third party reporting and the best ways to address them?**

EFAMA thinks that the approach appears sensible. However, as noted in the general comments for this section, clients should be able to rely automatically upon the executing or clearing broker and dual reporting should be avoided.

**Application for Registration (Article 52)**

**Q81: What is your view on these concerns and the ways proposed to address them? Would there be any other concerns to be addressed under the application for registration and tools that could be used?**

No comment

**Transparency and data availability (Article 67)**

**Q82: What level of aggregation should be considered for data being disclosed to the public?**

EFAMA believes that the lower the level of aggregation the bigger the transparency of the market will be to the public and market participants.

Market participants can make more out of information on transaction/portfolio level than out of information on a very aggregate level. It is key however that whatever level is chosen *anonymity* is guaranteed.

Trade repositories should be required to, among other things, provide aggregated data and statistics on types of transactions and types of counterparties to the public and to the competent authorities.

Supervisory authorities and public policy should recognize that there are reasons for the coexistence of different levels of transparency. Any information given to the general public should be carefully considered. A publication of e.g. individual open positions may influence the price formation process in the OTC markets, like bonds market or OTC derivatives market, and may reduce liquidity.

A trade repository should provide individual counterparty data on open positions, trading volumes and prices only to competent supervisory authorities for the purpose of maintaining financial stability.

EFAMA also feels that disclosure of individual company positions to the general public should be avoided in order to protect proprietary portfolio information. The level of granularity of information needs to be considered carefully. Only disclosure of statistics on standard products aggregated at a sufficiently high level to the public should be considered.

EFAMA also believes that the reporting of positions and transactions on a daily basis may be difficult as many products are not daily priced, valuations may differ between counterparties, and reconciliation within a TR may require additional rules and requirements.

**Q83: What should the frequency of public disclosure be (weekly? monthly?); and should it vary depending on the class of derivatives or liquidity impact concerns; if yes, how?**

EFAMA believes that it should be in line with the disclosure of the underlying in the regulated listed markets. Hence, different per class of derivatives.

In the context of the above objectives, it is not clear that publication of the highest level aggregate data need be done more frequently than every month. For example gross activity bucketed by IRS/OIS/CDS could be done monthly. More granular data (e.g. IRS by currency and tenor buckets, CDS by tenor and rating of underlying reference obligation) should be published on a lagged basis on a quarterly or semi-annual basis.

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