European Fund and Asset Management Association

EFAMA'S REPLY TO ESMA'S CONSULTATION ON THE REVIEW OF CLEARING THRESHOLDS UNDER EMIR

- 19 January 2022 -

INTRODUCTION

EFAMA welcomes the opportunity to comment on ESMA's ongoing review of Clearing Thresholds under EMIR. For asset managers the main issue continues to be the reclassification of ETDs as OTCs as a result of the non-equivalence of UK regulated markets. While we understand that a review is legally mandated at this point in time, we do not see value in recalibrating the various thresholds or making changes to the calculation methodologies unless these are in the two areas we define below. Our main concern revolves around the fact that changes would carry significant compliance costs while making little impact on the population of counterparties and notional captured by the thresholds. This is a point the ESMA consultation itself recognizes under the Conclusions chapter (paragraph 219).

We would, nevertheless, like to take the opportunity of this consultation to highlight two areas where changes in thresholds and methodologies would be meaningful (i.e have an impact on the population of counterparties and notional captured), and where the benefits would outweigh implementation costs.

UK ETDs

With respect to the issue of the reclassification of UK ETDs as OTCs, we would vastly prefer the removal of the need for an equivalence decision under Art.2a of EMIR but failing that we would support a solution with a temporary grandfathering of UK ETDs. This would mitigate against the high costs associated with the current threshold calculation for what are instruments that, ultimately, are already margined and cleared. This new approach would go some way in redressing the impact of thresholds that were defined without consideration of the Brexit effect. A temporary grandfathering of instruments (UK listed derivatives) could be considered, under the condition that a similar instrument is not traded on an EU venue. A prescribed list of these instruments would need to be produced to ensure that there is no market uncertainty on which instruments are captured by this. Initially these can be listed derivatives with UK ISINs. We believe this is a sensible approach in line with EMIR's risk mitigation goals, and it does not undermine the political sensitivity of equivalence discussion relating to the Derivatives Trading Obligation.

If the above approach is not implementable in the short-term, an alternate approach could be to raise the clearing thresholds to reflect the treatment of UK ETDs post Brexit.

FX Derivatives Contracts

We would support excluding physically settled FX Forwards and Swaps (the "**FX Derivatives Contracts**") from the clearing thresholds calculation, based on the same rationale under which they are excluded from variation margin requirements today. These are typically short-term transactions, they are not systemically important and are often used for hedging purposes.

Here we can look at the example of UCITS funds who together represent 52% of the population of entities subject to the clearing obligation (as compared to 5% for the NFCs). We find that FX Derivatives Contracts (FX Forwards, FX Swaps) are used for hedging operations to protect against currency risk, especially in conjunction with currency risk hedged share classes.

Furthermore, the crossing of the FX threshold is problematic in other ways: it forces the clearing of small positions in other asset classes which in themselves are far below their relevant asset class threshold.

We would recommend the exclusion of FX Derivatives Contracts from the threshold calculation to reflect the above.

Q4. Please provide data and arguments to illustrate the potential impact of the lack of an equivalence decision under Article 2a of EMIR and what could be done to alleviate your concerns (besides an equivalence decision)? Please specify the kind of transactions and activities that would be affected and the purpose of those, and whether there are alternatives.

One of the purposes of EMIR is to understand and reduce counterparty risk by introducing clearing requirements and/or increased margin/collateral requirements. This explicitly holds true for OTC transactions that will by exceeding the threshold be subject to exactly these additional requirements and safeguards, namely clearing at a CCP and/or initial margin following the EMIR uncleared margin rules. However, looking at futures and options listed in the UK, these additional requirements and safeguards are already met as in all cases initial and variation margin are exchanged on a daily basis, while being cleared at a CCP. Therefore, the risk characteristics of UK-listed futures and options are not comparable to other OTC instruments reflected in the threshold calculation and will not be changed in any way once the threshold is exceeded. Instead, UK listed ETDs are artificially increasing the "OTC" volume and in some cases even triggering clearing and/or margining requirements.

Against this background, we are requesting a temporary grandfathering as outlined in the introduction.

Q11. Considering the current coverage provided by the clearing thresholds in relation to currency derivatives and the different type of counterparties (FCs and NFCs); is there any aspect or issue you consider ESMA should look into or pay attention to? Please, in your answer, provide as granular details and any relevant data to illustrate your response.

Currency derivatives also comprise FX Derivatives Contracts which are predominantly used for hedging purposes either in a portfolio context or on a share class level in order to hedge currency risks for investors. These FX Derivatives Contracts may – depending on the fund/share class size and subscription/redemption activity by investors – appear large in absolute notional amounts and given the calculation methodology (add-up notionals, no netting by off-setting transactions) lead to breaches of the threshold limits requiring even a single IRS or CDS to be cleared even if the remaining OTC volume despite FX forwards would be well below any clearing requirements. Further, as FX Derivatives Contracts are exempt from any clearing and/or margin/collateral requirements, the inclusion of these transactions to threshold calculations that when exceeded trigger additional clearing and/or margin/collateral obligations appears disproportional. Therefore, we are asking for the exclusion of FX Derivatives Contracts form the threshold calculations as outlined in the introduction.