European Fund and Asset Management Association

EFAMA Position Paper on the EMIR REFIT, CCP Supervision and CCPs Recovery and Resolution Regulation

Introduction

EFAMA[1] welcomes the proposed draft regulations on the review of EMIR as well as the additional clarity provided in the interactions with CCPs.

We also welcome the approach chosen by the co-legislators to consider the framework applicable to derivatives in its entirety, including the anticipation of a regime for defaulting CCPs or Clearing members.

In our view, three main principles should guide the finalisation of those proposed legislations on derivatives:

(i) **Investors' protection**: if tax payers should be protected from a default of an investment firm investing proprietary assets, we believe that end-investors that are the same individuals as the tax payers should never provide a guarantee of any form to companies that are supposed to secure transactions or that are paid to execute services on behalf of their clients.

(ii) **Access to information**: Authorities and market participants should have readily access to relevant information. To achieve this goal, candidate CCPs should know in advance the criteria to fulfil to be authorised and should provide their recovery and resolution plans immediately. Additionally, information on the transactions should be provided in a format allowing automated treatment down to the level of instruments through the allocation of ISIN codes.

(iii) **Collateral availability**: To guarantee the efficiency of the markets and allow the most efficient use of risk mitigation tools, the use of collateral should be facilitated. Therefore, assets eligible for collateral should be extended both in terms of asset classes recognised as eligible and for all market participants, including CCPs and central banks. Lastly, the legal framework applicable to Financial Counterparties should permit the use of efficient portfolio management techniques allowing to transform assets in portfolios (such as corporate bonds or sustainable assets) into eligible collateral.

[1] EFAMA is the representative association for the European investment management industry. EFAMA represents through its 28 member associations and 62 corporate members close to EUR 23 trillion in assets under management of which EUR 14.9 trillion is managed by 59,588 investment funds at end Q2 2017. UCITS (Undertakings for Collective Investments in Transferable Securities) accounted for 31,294 of these funds, with the remaining 28,294 funds composed of AIFs (Alternative Investment Funds). For more information about EFAMA, please visit www.efama.org

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I. EMIR REFIT

EFAMA is of the opinion that, overall, the legislative proposal represents a real improvement compared to the existing EMIR regulation, notably because it improves the relevance of reporting obligations.

We wish to express our support for several elements proposed by the EU Commission and that are also underlined in the EU Parliament report on the review of EMIR:

- The Clearing obligation (CO) is made easier, particularly for non-financials (small and large corporates).
- The monitoring of the clearing threshold on an annual basis for mandatory clearing for NFCs is an improvement that will lighten the burden imposed also on NFC+.
- The proposal to have single-sided reporting obligations for some categories of instruments is also welcome but could be extended to other instruments.
- Pension funds exemption is better defined but should also be extended to other instruments that are developed for the benefits of pensions schemes.
- The suspension of the clearing obligation makes sense in times of stress and volatility.
- The Commission proposal for exempting small and mid-size financial counterparties from the clearing obligation seems an appropriate application of the principle of proportionality.

However, we also see some areas for improvements:

(1) REPORTING

EFAMA strongly supports initiatives aimed at streamlining the reporting requirements for all counterparties (and especially regulated funds such as UCITS and AIFs), thereby reducing the administrative burden and ensuring that the quality of data needed for monitoring derivatives markets and identifying financial stability risks is improved.

A. Single-sided reporting for derivatives

We strongly support the recommendation to introduce a single-sided reporting obligation for ETDs.

We also consider as a natural extension to request CCPs to report centrally cleared transactions to trade repositories. We believe that only trading venues and CCPs should be responsible and legally liable to report ETDs and centrally cleared trades on behalf of both counterparties to a trade repository as both already hold most of the details of those contracts. We further ask that the non-reporting counterparty be explicitly cleared from any other responsibility than the data on its identity it transferred to the reporting side.

Additionally, we urge the EU Co-legislators to extend even further the application of single-sided reporting for all OTC derivative contracts (cleared and non-cleared) to avoid a different reporting system within a regulation (single sided reporting for ETDs vs. double-sided reporting for OTC derivative contracts). Such a single-sided reporting, preferably by the sell-side, will ease the reporting obligation both for all market participants and for the regulators when analysing the data.

Additionally, and from a competitiveness perspective, single-sided reporting is the standard way to report in the USA, therefore an alignment of the obligations on our US competitors could also prove beneficial for the EU financial industry.

B. Transitional regime and "Backloading" of historic transactions

Intermediary implementing measures

We would recommend providing intermediary implementing measures in time to allow bridging the time difference between the current regime and the revised regime.

Terminated historic transactions

We strongly agree with the proposal to remove the obligation to report so-called historic transactions to a trade repository.

The obligation to report historic transactions requires significant efforts for the investment fund and management companies to retrieve and source such data. The value of such trade data will be of little use and many reports will be impossible to reconcile, as some counterparties may e.g. no longer exist. Besides, those historic trades do not pose any systemic risk.

C. Clarification of the "last in chain to report":

We would welcome a clarification that the clients of CM or CCPs as well as end-investors do not have to provide the described reporting and that the chain of reporting stops at the level of CMs, as foreseen under the Settlement Finality Directive, Article 2(a).

D. Harmonisation of reporting data fields

To facilitate reporting and to ensure homogeneous and efficient circulation of information, we believe that the standardization of identifiers is of paramount importance.

We strongly support the recommendation to further harmonize the data standards and formats based on ISO standards (ISO 20022) in the level 1 Regulation.

We believe that the public policy priority should be to use the only universally accepted and government supported industry standard setting system, the ISO system, which is part of the UN framework, and can be amended when need be.

Furthermore, we support LEI ROC efforts and agree with the work started by the FSB and CPMI/IOSCO to develop technical guidance and governance arrangements for the UTI and the UPI.

This standardization is a critical element also for derivatives transactions. We would like to insist on the need to have ISIN Codes attributed to all classes of assets, including OTC Derivatives as developed by the ISIN organisation (http://www.isin.org/isin-for-derivatives).

Therefore, we urge the EU Co-Legislators to support and implement ISIN codes as identifiers of all financial instruments, including OTC derivatives of all natures.

E. Limited changes to the reporting fields and their format

We would recommend limiting changes to the ongoing reporting obligations to the strict minimum necessary.

It is indeed important to bear in mind that changes in a reporting infrastructure pose similar challenges to firms as the building up of new systems.

(2) CCPs

A. Costs and Charges

Some clearing members do not disclose the price of clearing service offers and/or are not transparent about their rates. In addition, the legal regime applicable to clearing members allows them to review and increase at any time their services pricing, without requirement of transparency or pre-defined criteria.

We recommend inserting provisions in the proposed regulation that would force a transparency from clearing members on their prices and rates to ensure sufficient comparability and competition among clearing members in their commercial offerings.

B. CM access and offering.

CMs are often imposing on their clients more stringent conditions than the ones imposed by CCPs. The relationship between end-users and clearing members is uniquely a contractual relationship, causing difficulties for asset managers and regulated funds to meet their collateral obligations.

For example:

- The clearing members reserve the right to accept or not the clearing of transactions;
- The clearing members impose further conditions on transactions portability;
- The clearing members do use their own models to calculate the margin and collateral requirement that they can review at any time (and therefore can call higher margin than the once calculated by the CCP; and
- The clearing members can have a list of eligible type of collateral more restrictive than the one given by the CCP, addition of ratings trigger on bonds, and more conservative haircuts.

The negotiation power of small financial counterparties (categories 3 and 4) is also limited when interacting with clearing members. Furthermore, clearing members are less willing to offer client clearing services beyond their most important and biggest clients largely due to the stringent capital requirements applicable to them (e.g. BCBS Leverage Ratio).

Additionally, some CM are refusing to contract with some funds and asset managers due to their request to have specific segregation models, whilst funds and asset managers are still subject to clearing obligation.

Therefore, we believe that the Co-Legislators or ESMA with a mandate from the Commission, should develop a model that should force CM to:

- Provide an offering closer to the CCPs requirements;
- At minima, align lists of eligible collateral that CCPs accept;
- Not apply different pricing based on segregation models;
- Introduce a precise definition of the notions of "agent" and "counterparty" in regard to the client relationship;
- Limit the additional conditions imposed by the clearing members on the transaction portability; and
- Limit the possibility for clearing members to review and increase at any moment the pricing of their services.

An alternative would be to discharge all category 3 and 4 from the clearing obligation.

(3) COLLATERAL

A. Eligible Collateral

CMs and CCPs should be encouraged to extend the range of assets eligible for margining.

At CCPs' level, only cash is accepted as variation margin. However, a significant number of investment funds are facing severe difficulties to deliver cash as they typically do not hold significant amounts of cash as part of their assets and because asset transformation into cash collateral is restricted (see also our point 3.b below).

Therefore, we would strongly recommend recognising the eligibility of a broader range of assets at CCP and Clearing Member's levels, adding in particular:

- Government bonds, which would facilitate alignment with initial margin eligible assets;
- Corporate bonds, which should be eligible in any circumstances to offer the broadest possible range of eligible assets to avoid liquidity crunches especially in stressed periods;
- Equities, which should be eligible for the same reasons despite their higher volatility that is however controlled by daily Marked to Market; and
- Commodities such as gold in exceptional circumstances (for funds authorized to invest in those assets)
- HQLA funds shares

At clearing members' level, we also noted in several occasions that some CMs impose more stringent criteria than the ones given by the CCP (e.g. on the list of eligible collateral more restrictive, addition of, ratings trigger on bonds and higher conservative haircuts), therefore increasing the disequilibrium in disfavour of end-investors and intensifying the liquidity squeeze for UCITS triggered by the ESMAs Guidelines on ETFs and other UCITS issues (the "ESMA Guidelines" - cf. Point 42 and 43j of ESMA/2014/937).

B. Impacts on UCITS

As expressed on multiple occasions and in different contexts (such as EMIR, SFTR, UCITS V), the ESMA Guidelines (which have been implemented and extended to AIFs in some Member States are causing severe difficulties to meet margins requirements.

In this context, we strongly reiterate our position that UCITS could face substantial difficulties to provide cash collateral in cases of centrally and bilaterally cleared OTC derivative transactions under EMIR.

Use of repo

We consider that the above-mentioned Guidelines unduly restrict UCITS access to CCP clearing, due to the inability for UCITS to access liquidity required for cash collateral contributions via repurchase agreements.

Indeed, the mentioned Guidelines prohibit to post cash received in a repo transaction as collateral to a CCP or to the clearing member. Unlike other Financial Counterparts, regulated funds are subject to a cash borrowing restriction of 10% of their net asset value and are subject to strict rules on the use of leverage. In that context, it is obvious that UCITS will be constrained in their ability to use OTC derivatives subject to a clearing obligation.

Therefore, and to facilitate asset transformation into eligible collateral to meet margin call, we urge the EU Co-Legislators to:

- Either confirm that repos can be used as asset transformation techniques;
- Or encourage ESMA to amend the Guidelines to allow the European investment fund industry to use repos for transformation of assets into cash collateral.

Concentration limits

The diversification limits on counterparty exposures in OTC derivatives transactions were introduced in the UCITS Directive long before the EMIR regulation was adopted, with the clear objective of forcing UCITS funds to diversify their counterparty exposures and, therefore, to mitigate their risks and the importance of their potential losses in case of default of a counterparty to such OTC derivative transactions.

However, we see a first possible conflict with the very purpose of the central clearing obligation under the EMIR regulation as the model is concentrating risk on fewer actors (CMs and CCPs).

Secondly and directly related to UCITS rules, we consider that the role of the CCPs is precisely to guarantee the execution of the most commonly used and most standardised OTC derivatives transactions and to reduce (if not completely supress) the counterparty risks on OTC derivative transactions through the intervention of CCPs.

This intervention of CCPs, alone, should be enough to convince the European Co-Legislators that UCITS concentration limits should be removed in this case.

That is the reason why EFAMA also strongly disagrees with ESMA's view (ESMA opinion (2015/ESMA/880) on "Impact of Regulation 648/2012 on Articles 50(1)(g) (iii) and 52 and of Directive 2009/65/EC for over-the-counter financial derivative transactions that are centrally cleared") that the counterparty risk to the CCP should be applied to funds, although the latter has no direct legal relationship with the CCP.

(4) LEGAL CERTAINTY AND HOMOGENEITY

Further efforts should be made to ensure international legal convergence.

A. Forbearance

Considering the issue faced earlier this year on the documentation and application of VM and the recognized need for revision of the VM for FX's regime and while we understand that neither the ESAs nor the EU Commission have yet the formal power to provide "no-action relief", we would recommend developing a global forbearance mechanism in EU legal tools available for every type of EU legislation (like the US "no-action relief" mechanism)[2].

We believe that, based on those two first cases of ESA's "comfort communications" to NCAs issued in February 2017 and November 2017, it would make sense to officially recognize such a power in the context of forthcoming local implementations of pieces of EU legislation in the context of ESAs' Review. In our view, it would be consistent with Article 1 of the ESAs regulations, which note that the Authorities "shall contribute to improving the functioning of the internal market, including a sound, effective and consistent level of regulation and supervision" without endangering market stability.

B. Foreign Exchanges

We would welcome a carve-out for FX derivative instruments (FX forwards and FX swaps) from margin obligations for funds and asset managers, irrespective of their contract tenor. For the avoidance of doubt, it should be specified that currency swaps are also exempted since they are a component of a forward contract.

Considering that FX Forwards de facto are hedging agreements used for risk mitigation purposes it is indeed counterproductive to apply this additional burden on the investment funds and their managers. Requiring margining for FX derivative instruments will have a detrimental effect on all market participants with limited leverage capability such as retail investors and smaller counterparties.

When the VM requirement on FX Forwards will become applicable (on 3rd January 2018), the above will increase the operational issues involved in handling margin and put pressure on liquidity.

Additionally, the current situation creates legal uncertainty at international level, as some other countries (such as the USA) do not have similar requirements.

[2] For further details, please refer to EFAMA's position paper on the review of the ESAs.

(5) CLEARING THRESHOLDS AND FAIR ACCESS

A. Thresholds for clearing.

As mentioned above[3], EFAMA strongly supports the proposal to relieve small financial counterparties with a limited clearing volume (especially UCITS and AIFs) from the clearing obligation by introducing a clearing threshold.

We concur with the analysis that it is economically unfeasible to fulfil the clearing obligation for the smallest financial counterparties with a limited clearing volume such as UCITS/AIFs (category 3).

In addition, EFAMA also requests an extension of the period of compliance (one year and not four months as proposed) where the concerned counterparty exceeds the clearing exemption threshold, to enable it to seek one or more clearing members and to negotiate contracts with them.

The Co-Legislators or ESMA with a mandate from the EU Commission should consider the legal and operational complexity of the principal to principal model and consider that buy side universe has to establish the operational clearing structure for funds internally and by implicating more actors that are present in the interbank market (custodians, administrators, valuation agents…).

B. Fair Access

We support the principle that institutions offering client clearing solutions (e.g. clearing brokers) should provide such a service under fair, reasonable and non-discriminatory commercial terms ("FRAND" principles).

Due to the low number of transactions and the limited clearing volume executed by our small and medium sized members, using a clearing member will become disproportionately expensive as the high basic fees are calculated independently of the transaction. Some clearing members do not offer a cost-effective client clearing model which is a good offer for our small and medium-sized member firms.

Lastly, we wish to insist on the difficulties to implement the clearing requirements under EMIR and the obligation to trade centrally cleared derivatives on a trading venue under MiFIR.

Therefore, we would recommend to:

- Impose an obligation for CMs to provide the service "at cost" to enlarge the clearing market;
- Confirm that the firms exempted from the clearing obligation are also excluded from the obligation to trade on all market under MiFIR.

[3] See our introductory remark on page 2, sixth point of this position paper.

C. Transparency of CCPs

In our views, CCPs should:

- Provide the tools to simulate their initial margin requirements to all direct and indirect clients (similarly to CMs);
- A detailed synthesis of the characteristics of the initial margin models that they use; and
- To notify in advance the competent supervisory authority as well as direct and indirect clients of any substantial changes by means of a validated communication.

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II. EMIR CCP Supervision

EFAMA broadly welcomes the legislative proposal published by the European Commission to enhance the supervisory arrangements for EU and third-country CCPs in the interest of further market integration, financial stability and a level-playing field.

However, EFAMA does not intend to take position in the debate raised in the context of this proposal about Euro clearing.

Whatever the decision made in this respect, our only concern is to make sure that the new regulatory framework on the supervision of EU and third-country CCPs is designed in such a way as to preserve the safety and the financial stability of the markets and the protection of our clients, the end-investors.

With this objective in mind, we wish to make the following remarks:

(1) EXTENDED SUPERVISORY ROLE

We support the proposal to enhance the power of ESMA, the ECB and the relevant national Central Banks (NCB) in the EU to supervise EU and third-country CCPs.

Indeed, we consider that:

- The current supervisory EMIR-framework shows some limitations as it provides the EU authorities (e.g. ESMA, ECB and the national competent authorities (NCA)) and NCBs with limited tools for obtaining and accessing information to analyse and aggregate the CCPs' risks and their members counterparty's risk exposures;
- Currently in an event of a third-country CCP default, only its Central Bank can provide emergency liquidity assistance. The ECB and their members do not have legal powers to provide such liquidity facility and would need to rely on the willingness of the national Central Banks of the third country to allocate such liquidity resources to the CCP;
- Most importantly, EU regulators do not have direct supervisory powers with respect to third country systemically-important CCPs to take any action necessary to preserve the safety and financial stability of the Euro, the Eurozone and ultimately the EU and its citizens.

Therefore, we believe that the EU authorities must have access to all information at any time, including those provided by the third country NCA and/or the NCB on the CCP and their members counterparty's risk exposures.

(2) THIRD-COUNTRY CCP RECOGNITION

We believe that the criteria for recognition of CCPs should be defined in the Level 1 of the revised regulation to ensure homogeneity and predictability in the implementation of the new rules.

Additionally, we are of the view that those criteria should be available publicly to allow ex-ante assessment of the conditions to be met to obtain such recognition and should be properly calibrated to guarantee efficient supervisory mechanisms.

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III. CCP Recovery and Resolution Regulation

EFAMA welcomes the European Commission's proposal for a regulation on the recovery and resolution of central counterparties (CCPs), as published on 28 November 2016, as well as the EU Parliament ECON Committee draft report on this proposal.

Our industry fundamentally supports every effort made to strengthen financial stability, as per the G20 requirements.

The positive elements that we note are the insertion of more references in the interest of end-investors, formally recognising the need to protect end-investors in the CCP recovery and resolution plans.

However, we would insist on the following facts:

- End-investors are holders of shares of regulated funds which are obliged under EMIR to clear their trades through a CCP. As mere passive users of CCP infrastructures and unlike clearing members, end-investors have no control over the governance and operations of a CCP. Consequently, they should not be impacted via margin gains haircutting in neither recovery nor resolution phases without forms of adequate compensation; and
- Recovery plans should become more binding. CCPs that wish to deviate from their recovery plans will not only need to notify, but also should have to ask for permission and timely inform their direct and indirect clients.

Lastly, as a matter of principle to protect end-investors, we disagree with every type of haircutting. Instead, concentration risks associated with proprietary transactions of clearing members should be mitigated by making critical volumes subject to additional collateralisation requirements. Should any form of haircutting remain, we need the application of a robust No Creditor Worse Off ("NCWO") principle.

(1) Recovery (Articles 9-12)

A. Differentiation between default and non-default losses

We welcome every initiative that would specify the distinction between DF vs. NDF events/losses by inserting a clear distinction between the two scenarios directly in the recovery plans. This should become an integral part of a CCP operational rulebook.

However, Articles 9 *et seq.* of the proposal are silent as to the possible origins of such financial distress. In that perspective, EFAMA resolutely supports the clearer distinction made in the ECON Draft Report between default and non-default losses.

Therefore, we would

- Distinguish between the default of one or more clearing members (the so-called "default events") from the occurrence of other events implying risks and direct losses to the CCP (the so-called "non-default events"). Such distinction would ultimately avoid that the default waterfall be used to absorb non-default losses[4];

- Strongly recommend that the future regulation clarify that the use of the default waterfall should be restricted to default losses only.

B. The relevance of end-clients

In its detailed explanation of the specific provisions of the proposal, the Commission has indicated that clearing members must inform their end-clients of the potential transmission of losses arising from the exercise of recovery tools by the CCP[5].

We consider that considerations around end-client interests and the extent to which these may in part or entirely be included in a recovery/resolution phase, depend ultimately on the specific conditions reflected in a CCPs own rulebook.

In our Members' experience, such rulebooks may or may not adequately account for the interests of end-investors, particularly insofar as variation margin haircutting is concerned.

We therefore recommend that clearing members should be prohibited from passing the burden of a CCP's recovery onto end-clients, particularly via VMGH. Such is also the rationale behind key provisions of the UCITS Directive, whereby asset management companies, or the funds they manage, are not allowed to act as guarantors on behalf of third parties.

As end-clients were not sufficiently addressed in the proposal, we welcome the more explicit references to them in the ECON draft report. Such references will consequently aid the inclusion of end-client interests to figure more prominently in CCP rulebooks.

C. Avoiding VMGH as a loss-allocation tool

We consider that the use of VMGH on client's assets is at odds with the principle protecting end-investors.

This is even worse if the use of VMGH appears as a loss allocation tool in the recovery phase (whereas we could accept it in a resolution phase, albeit under the strict control of the resolution authority).

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[4] In general, according to the typical "default waterfall", the defaulting clearing members' own initial margin requirements, followed by its own contributions to the mutualised guarantee fund, are the first line of defence. Where losses exceed these resources, a CCP's own committed capital (known more commonly as "skin in the game") is tapped into as a further loss-absorption mean, followed by the reserve contributions of the other (non-defaulting) clearing members to the guarantee fund, and eventually also on the unfunded "assessment" of the clearing members. As a last resort, at the end of the waterfall, are the several loss allocation tools, as envisaged by the Commission's proposal. Where these measures fail to restore a matched book, the CCP ultimately retains the right to resort to the partial or full tear-up of member contracts.

[5] Article 9(7) refers to the minimum contents of Section A of the regulation's accompanying Annex, whereby the recovery plan shall merely (…) "consider the interests of all stakeholders that are likely to be affected by that plan" (…), including asset managers' end-clients invested in their funds. Article 10(3) further requires that the recovery plan be submitted to competent authorities for these to appreciate, *inter alia*, the impact that the plan's implementation may have on clearing members and their clients (i.e. investment funds and their end-investors).

EFAMA is in principle against such use. Variation margin belongs – both technically and by nature - to investors, which are at the same time end-clients to clearing members. Furthermore, VMGH would unmistakably impair hedging strategies to the detriment of end-investors.

It should not be seized to shore-up losses (i.e. default and/or non-default ones) over which investors have no control.

Additionally, as end-users of centralised clearing, investors already pay the corresponding fees and premiums included in the price of transactions, thus making additional margin haircutting difficult to justify.

One should take into consideration that the usage of VMGH would only be triggered by a realised concentration risk associated with the proprietary transactions of clearing members. Rather than accepting that risk and creating a liability for third parties not being involved (VMGH), clearing members should provide the CCP with additional collateral mitigating the concentration risk relating to their proprietary transactions above a critical volume.

Possible recourse to VMGH should at the very most be considered exceptionally under very strict and pre-defined conditions set out in resolution plans only, reflected in the relevant CCP rulebooks and to be exercised under the control of the resolution authority[6].

Therefore, in light of the significant discretion CCPs would exercise over end-clients' margin and in concomitance with no indication as to adequate means of compensation in the text of the proposed regulation, we would strongly advocate that VMGH not be considered among the recovery tools at all.

Were VMGH to be exercised – we insist, as resolution tool only – EFAMA would recommend that it be used as:

- A mean of very last resort,
- Subject to a series of tight and pre-defined constraints;
- Granting end-client compensation via adequate means; and
- Be authorised by the competent authority considering the broader stakeholder interests, especially those of buy-side end-investors.

D. Duration of the recovery phase

In terms of the duration of both recovery and resolution processes, derivative markets are such that any lengthy prolongation of such processes, beyond the prompt re-establishment of positions in a matched book, would undermine legal certainty and negatively affect counterparties.

As explained above and in some instances, it may be desirable for competent authorities to allow the temporary suspension of the central clearing obligation. This mechanism might even become automatic for derivative contract types which do not clear through at least a second CCP, or where

[6] *A fortiori*, initial margin haircutting, although not explicitly referenced in the proposed regulation, should be fully prohibited as a loss allocation tool, both for recovery and resolution.

alternative CCPs and their non-defaulting clearing members refuse to take additional positions onto their books (e.g. via the auction process)[7].

E. Access to Central Bank facilities

Both recovery and resolution chapters of the proposal envisage recourse to Central Bank facilities under standard terms.

In line with our response to the Commission's consultation on the review of EMIR in August 2016, we believe that a CCP's access to Central Bank facilities, although not automatic, should only come once all other measures - prior to the seizure of clients' funds - have proven insufficient to ensure a CCP's recovery[8].

Such measures may include mandatory stress-testing, increasing a CCP's own resources (*alias* "skin-in-the-game"), or exploring the possibility for a CCP to issue "bail-in able" debts as a further mean of strengthening the default waterfall.

In parallel, we believe that granting CCPs access to Central Bank facilities would further strengthen a CCP's resilience, reduce the likelihood of placing a CCP into a resolution phase and ultimately improve end-users' confidence in central clearing[9].

CCP should have access to Central Bank facilities, provided that some existing guarantees are increased and that a framework for stress-testing is developed.

We believe that granting CCPs access to Central Bank facilities and the fact that some CCPs have bank status would:
- Further strengthen CCP resilience;
- Reduce the risk of CCP Resolution; and, ultimately
- Improve end-user's (such as funds and asset managers) confidence in central clearing.

In more detail, even if we support the idea of access to Central Bank credit lines, we believe that this possibility should only come in due time, i.e. prior to haircutting margins and after the use of CCP and

[7] For further arguments in this regard, please refer to the EFAMA response of August 2016 to the European Commission's consultation on the review of EMIR; available at: http://www.efama.org/Publications/Public/Derivatives/EFAMA_Reply_EU_Commission_Consultation_EMIR_Review.pdf

[8] In this regard, please refer to the EFAMA response to the European Commission's consultation on the review of EMIR in August 2016; available at: http://www.efama.org/Publications/Public/Derivatives/EFAMA_Reply_EU_Commission_Consultation_EMIR_Review.pdf

[9] In this regard, it is important to bear in mind that, unlike banks, most end-users do not have direct access to Central Bank liquidity facilities and clearing members usually pass liquidity risks onto the end-users. To meet margin calls, the latter either have to rely on the repo market, or sell the underlying portfolio assets in the market to meet margin calls. We note that UCITS funds – and in some Member States, even AIFs - no longer have the possibility to access liquidity via the repo market in light of paragraphs 42 and 43 of the *ESMA Guidelines on ETFs and other UCITS issues* (ESMA/2014/937). Such end-users therefore confront the problem to meet variation margins and/or cash calls from non-defaulting clearing members, as well as from other counterparties, should the initial collateral deposited be consumed as part of a loss allocation in a clearing member's default occurrence.

CMs' resources. We also think that this access should not be imposed to Central Banks and that this access should not be a prerequisite to granting access, authorising or recognising a CCP.

Therefore, prior to access to Central Bank facilities, we would urge the EU Co-Legislators to strengthen the existing regime by:

- Developing a mandatory stress testing framework with publicly available results as it is the case for banks;
- Increasing CCP resources through increased CCP skin-in-the-game to broaden the buffer between the 'real economy' and CCP failure; and
- Exploring the issuance of "bail-in-able" debts by CCPs as a means of strengthening the default waterfall, increasing the above-mentioned buffer.

End-client protection, together with a CCP's own resilience, could also be improved through the opportunity for end-clients to gain access to the CCP through sponsored access – as offered by a clearing member - or through a clearing member acting as an agent (depending on the clearing model). Although these offers are currently being considered and/or proposed by selected CCPs, they could provide original set-ups where the client's exposure to a CCP would be supported by the clearing member, with greater certainty.

F. Increase transparency

To this day, end-clients (i.e. buy-side firms) do not have precise information on the recovery plans of CCPs. As part of this review's objective to increase transparency and disclosure in clearing, we consider that the CCP recovery plans shall also immediately be made available to the public, or at least made available to the clearing members' clients, without delay of any form.

We therefore ask that an obligation be imposed on the CCPs to legibly present the main features of their rules and to notify in advance of any substantial modification, not only clearing members but also for clients, and more generally the public by a validated communication with the competent supervisory authority.

(2) Resolution (Articles 13-73)

Like the above provisions on the CCP recovery plan, the contents of the CCP resolution plan shall also take into consideration the impact of its implementation on end-clients as per Article 13(3), letter b). In this regard, we would re-state our considerations above, relative to the proposal's general language around the treatment of end-clients in the resolution phase.

As end-clients are not expressly addressed in the proposal, we recommend that adequate and explicit references to them be included, as in the preparation of the resolution plans before authorities mandated by the regulation.

A. Early intervention powers

Regarding the early intervention powers of the competent authority under Article 19 of the proposal, EFAMA fully endorses their rationale, as we support the flexibility granted to the resolution authority - supported when necessary by the resolution college - to make the assessment of resolvability under the previous Article 16 of the proposal.

As we have already argued above, early intervention should ensure that end-client interests are sufficiently represented *vis-à-vis* CCPs as profit-making entities. In particular, we deem crucial to improve the protection of end-client interests, which are neither treated in the proposed regulation in any detail, nor adequately represented in the typical bilateral dealings between a CCP and its own clearing members.
Regarding clearing members' bankruptcy, we insist on the fact that end-clients of clearing members should be excluded from the competent authority's appreciation of incentives.

End-clients, as asset managers and their funds more specifically, are merely passive users of central clearing services and are typically not offered incentives on par with clearing members.

As such, they are typically not represented at the level of CCP risk committees, nor are they able to influence a CCP's risk-taking or risk-management activities.

We understand that an underlying aim could be to distribute potential losses beyond CCPs and their more immediate clearing members. Conversely, we view the allocation of such losses on end-clients as unjustified and there would be therefore no reason for the competent authority to include clearing members' end-clients in its considerations around incentive alignments.

B. Reduction of gains payable to non-defaulting clearing members (and their end-clients)

We refer to the above point on VMGH, as presented under Article 30(1) of the proposal.

We note that, absent any form of compensation, an asset manager would be using end-client funds to pay for access to central clearing, with the risk that in a resolution phase, its investors' gains may be seized.

However, compared to clearing members or dealers who typically manage a flat market position, VMGH will penalise fund end-investors, as funds – unlike the former stakeholders – hold directional positions.

We also believe that end-client money should not be seized to honour resolution cash calls from the non-defaulting clearing members, as per Article 31(1) of the proposal.

C. "No creditor worse off" principle

Considering the "no creditor worse off" principle under Article 60 and 61 of the proposal, it would be impossible for any independent valuator to assess *ex-ante*

- The amounts by which margin gains may be effectively "cut", as well as
- The amounts to be made subject to a cash call, when attempting to prove the counterfactual.

Additionally, about the "no creditor worse off" principle, we observe that Article 60(1) only references the CCP's shareholders, creditor and clearing members, thereby explicitly excluding end-investors from the valuation of the likely impacts stemming from the use of the resolution tools, as well as from any compensation in the form of payment entitlements as per Article 60(2). We understand it was the Commission proposal's intent to in principle exclude clearing members' end-clients from any contribution to the recovery or resolution of a CCP and agree with this approach. Were this principle to not be upheld, it is critical for end-investors to be included in the independent valuator's NCWO assessment as *de facto* creditors and benefit from a preferential seniority treatment.

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