efama
European Fund and Asset Management Association

EFAMA reply to the EU Commission's consultation on EMIR REFIT

EFAMA[1] welcomes the opportunity to comment on the EU Commission's proposed EMIR refit.

We want to congratulate the EU Commission for the excellent quality of the prosed text.

We also wish to thank the Commission for having taken into consideration some items such as front- and back- loading issues for which we have frequently raised concerns, as well as the addition of a “clearing stop mechanism”.

We also want to express our support to the Commission's efforts to foster financial stability whilst protecting transparency of OTC derivative positions and access to clearing.

From our perspective, overall, we are of the opinion that the legislative proposal is a real improvement compared to the current regime, as it also improves relevance of reporting obligations.

However, we also see some room for further clarifications or additional changes:

(1) Reporting

a. Extension to all type of cleared derivatives:

The regime of single-sided reporting should be extended to ETD and centrally cleared transactions, considering that CCPs are already receiving those contracts and that the transactions’ information is similar to a large extent.

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

We ask the Commission to confirm that clients 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.

[1] EFAMA is the representative association for the European investment management industry. EFAMA represents through its 28 member associations and 61 corporate members close to EUR 23 trillion in assets under management of which EUR 14.1 trillion managed by 58,400 investment funds at end 2016. Just over 30,600 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining 27,800 funds composed of AIFs (Alternative Investment Funds). For more information about EFAMA, please visit www.efama.org

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c. Harmonising the reporting fields and their format

We would also ask the Commission to harmonise reporting obligations and reporting formats, referring to ISO standards (e.g. ISIN, CFI, LEI, ISO20022, etc.), as well as to the UTI and UPI developed by the CPMI/IOSCO, in the Level 1 text.

It is important to bear in mind that changes to a reporting standard poses similar challenges to firms as building up new systems.

d. Reporting models.

Some clearing members do not disclose the price of clearing service offers and/or are not transparent about their rates, often imposing different conditions according to custody models.

Therefore, we ask the Commission to develop, or to mandate ESMA to develop, rules that impose to CMs to be a pass-through of the CCP's requirements or at least to encourage CMs to not deviate from CCPs requirements.

e. Use of identifier.

In line with point c. above, in order to facilitate reporting and to ensure the homogeneous and efficient circulation of information, we believe that the standardisation of identifiers is of paramount importance.

This standardisation is a critical element also for derivatives transactions.

Therefore, we urge the Commission to support and implement ISIN code, as well as other identifiers of financial instruments, including OTC derivatives of all types.

f. Transparency in costs and changes.

As expressed above, it is important that clients of the clearing members are included in increased transparency provisions. Buy-side firms also need visibility on changes to models as it would impact margin calculations (see also our point 2.2).

(2) CCPs

a. Access to Central Bank money

EFAMA would recommend CCPs have access to Central Bank money, provided that some existing guarantees are increased and that a framework for stress-testing is developed. Such possibility should only come in due time, i.e. prior to haircutting margins and after the use of CCP resources, and not be a prerequisite to granting access, authorising or recognising a CCP.

We believe that granting CCPs access to Central Bank money 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.

Access to Central Bank money would, however, need to be accompanied by strengthening the existing regime through:

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

b. Clearing Members' 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.

Additionally, some clearing members do not disclose the price of clearing service offers and/or are not transparent about their rates.

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

Therefore, we are of the opinion that the Commission, 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, and
- not apply different pricing based on segregation models further than reasonably technically relevant.

Finally, we strongly support the FRAND initiative foreseen by the Commission and look forward to engage with it on its future contents.

(3) Eligible collateral

We ask the Commission to strongly encourage CMs and CCPs to extend the range of assets eligible for margining.

At CCPs, only cash is accepted as variation margin. However, several funds are facing severe difficulties to deliver cash as collateral while needing to be fully invested to meet their long-term goals in line with investors' preferences.

At clearing members' level, we also noted in several occasions that some CMs impose more stringent eligibility criteria that place end-investors at a disadvantage and intensify the liquidity squeeze for UCITS stemming from ESMAs Guidelines on ETFs and other UCITS issues (cf. Point 42 and 43j of ESMA/2014/937).

Therefore, we urge the European Commission to:

- Require from ESMA to modify its Guidelines on ETFs and other UCITS issues (ESMA/2014/937, respectively former ESMA/2012/832, which has been implemented and extended to AIF in some member states) that removes UCITS' ability to access liquidity required for cash collateral contributions via repurchase agreements (cf. para. 42 in combination with para. 43 j) of the said Guidelines).
- deem eligible a broader range of assets at CCP and Clearing Member's levels such as:
  - government bonds;
  - corporate bonds, which should be eligible in any circumstances to offer the broadest possible range of eligible assets to avoid a liquidity crunch especially in stressed periods;
  - equities, which should be eligible for the same reasons despite their higher volatility that is however controlled by daily mark to market;
  - funds that invest in eligible securities (e.g. MMFs or funds invested in equities, government or liquid corporate bonds); and
  - commodities such as gold in exceptional circumstances.

(4) Legal certainty and homogeneity

a. Front- and back- Loading

We ask the Commission to provide intermediary implementing measures in time to allow bridging the time difference between the current regime and the revised regime.

b. International convergence

Further efforts should be made to ensure international convergence.

c. Forbearance

Considering the issue faced earlier this year on the documentation and application of VM, we would recommend to develop a forbearance mechanism in EU legal tools, similar to e.g. the US "no-action relief).

While we understand that the ESAs do not have formal power to provide "no-action relief", we believe that alternative actions should be undertaken by the Commission, eventually through a mandate to the ESAs [2]in order to ensure the implementation of rules without endangering market stability.

[2] In this regard, we refer to Article 1 of the ESAs' regulations, which note that the Authorities "shall contribute to improving the functioning of the internal market, including in particular a sound, effective and consistent level of regulation and supervision".

d. Foreign Exchange

We would welcome a carve-out for FX forwards from margin obligation, irrespective of their contract tenor.

The absence of agreement on this aspect would negatively impact retail investors and smaller counterparties.

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

e. MiFIR trading obligation for derivatives

We ask the Commission to confirm that the firms exempted from the clearing obligation are also excluded from the obligation to trade on a regulated market under MiFIR.

(5) Impacts from UCITS

As expressed on many occasions and for multiple pieces of legislation (i.a. EMIR, SFTR, UCITS V), the ESMA Guidelines on ETF and other UCITS issues (revised in 2014) are causing severe difficulties to meet margin requirements.

a. Use of repo

UCITS rules, for example, restrict the use of cash received from repo transactions to provide collateral. Such rules cause severe impediments to meeting collateral requirements under EMIR.

b. 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, the very purpose of the central clearing obligation under the EMIR regulation 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 Commission that a change to the UCITS counterparty exposure limits is necessary as UCITS are experiencing difficulties in complying with the concentration limits while increasing their exposure to CCPs due to the EMIR clearing requirement.

In addition, we trust that such amendments would be in line with the recommendations provided by ESMA to the EU institutions in May 2015 in the 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".

(6) Treatment of Category 3 entities

In general, EFAMA would favour the broad exemption of UCITS/AIFs as Category 3 entities from the general clearing obligation, in light of the applicable and extensive collateralisation requirements and of the fact that creating new sub-categories may increase the framework's overall complexity. Nevertheless, in view of the proposal's overarching objectives, we remain supportive of a more granular categorisation within Category 3 for those smaller and/or medium-sized firms.

The latter are characterised by a limited volume of clearing activity and confront difficulties when finding clearing members and setting-up legal and operational arrangements with them in order to access a CCP. Also, their negotiation power is relatively limited when compared to those of clearing members. Typically, clearing members may also be reticent to offer clearing services beyond their largest and most prominent clients largely, due to the stringent capital requirements applicable to them (e.g. BCBS Leverage Ratio). In sum, due to the lower number of transactions and the limited clearing volumes executed by small and medium sized entities, using a clearing member will disproportionately become more expensive as the high basic fees are calculated independently of the transaction.

(7) Other topics

With regard to financial counterparties - as per Articles 2(8) and 4a - we would ask the Commission to grant a longer period for compliance (i.e. one year instead of four months as proposed), where the counterparty concerned exceeds the clearing exemption threshold. A longer transition period would enable it to seek one or more clearing members with which to subsequently negotiate contracts. We note that there are substantial legal and operational complexities to be accounted for when buy-side firms have to establish an operational clearing structure for funds internally, while also involving other actors present in the interbank market (e.g. custodians, administrators, valuation agents, etc.). In addition, we also ask the Commission to keep the existing definition of "financial counterparty", as a change of such definition would be disadvantageous for products like ABS.

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