



## **FIA Europe and IA – Response to ESMA Consultation on Indirect Clearing Arrangements under EMIR and MiFIR**

### **Introductory comments**

FIA Europe and the Investment Association ("IA") welcome ESMA's Consultation Paper of 5 November 2015 on Indirect Clearing Arrangements under EMIR and MiFIR (the "CP") and are pleased to submit these comments with respect to the accompanying draft Regulatory Technical Standards ("RTS") on Indirect Clearing under MiFIR. These comments take into account the views of an indirect clearing working group of FIA Europe's members, including clearing members and some CCPs, with which IA fully agrees and endorses.

For ease of review, we have structured our response as follows:

- Part I – A description of our key issues regarding the current draft of the RTS under MiFIR and a summary of the proposed solutions;
- Part II – A proposed revised draft of the RTS under MiFIR (the "**Revised Draft RTS**") which addresses our concerns with the current draft RTS and seeks to provide a robust and workable indirect clearing regime for exchange traded derivatives ("**ETD**");
- Part III – A commentary table setting out in detail the basis for each of the amendments we propose in the Revised Draft RTS; and
- Annex – A summary of our responses to the questions posed in the CP.

Our comments are limited to the draft RTS under MiFIR, which will apply in respect of indirect clearing arrangements for ETD. With respect to indirect clearing of OTC derivatives, we have had the opportunity to review the responses of the International Swaps and Derivatives Association, Inc., and fully support those comments. We note that whilst we understand that ESMA is mandated to ensure consistency of the RTS on indirect clearing under MiFIR with those under EMIR, we do not think this should require the two sets of RTS to be identical in every respect. Indeed, we consider that certain differences between the RTS on indirect clearing under MiFIR and EMIR will be necessary to ensure that they are suitable for the indirect clearing of ETD and OTC derivatives respectively.

### **Part I: Key Concerns**

The ETD market is an established, well-functioning and generally highly liquid market involving standardised products and the vast majority, if not all, of ETD products are already centrally cleared. Indirect clearing arrangements, including those where a global clearing services provider (who is not a direct clearing member of relevant CCPs) engages the services of direct clearing members of those CCPs to clear its clients' trades, already form a part of the market standard model for ETD business.

We acknowledge and appreciate that ESMA has sought to address a number of the concerns raised by market participants in response to the previous consultation, in order to achieve a workable solution for the indirect clearing of ETD, whilst taking into account the requirements of Article 30 MiFIR. In particular, we welcome ESMA's changes to:

- take into account the application of 'haircuts' to non-cash margin to manage market risk;
- clarify that excess margin may be treated in accordance with relevant terms of the indirect clearing arrangements (as noted in our response to question 6 of the CP);
- allow clients to provide services using a NOSA to indirect clients who have not confirmed their choice of account structure within a reasonable period of time (as noted in our response to question 5 of the CP); and
- clarify that the requirements on clearing members and clients in relation to leapfrog payments only apply where the indirect client has selected a GOSA.

However, we believe that certain features of the current draft MiFIR RTS still pose significant legal and practical challenges, many of which the industry has been grappling with for some time in the context of indirect clearing of OTC derivatives under EMIR. If these challenges are not solved, this could result in a decline in market participants' willingness to engage in indirect clearing arrangements in light of the resultant operational, legal, re-papering, business, capital and compliance requirements.

Indirect clearing rules are intended to bring greater access to clearing for end-users and to reduce default risk for clients further down the chain. However, inappropriately designed and executed implementation could counter those aims. We are particularly concerned with the operational costs and complexities that would be introduced by the MiFIR RTS in their current form, as there is a risk that such costs and complexities may not be operationally supportable by all clearing members and their clients currently providing market access to indirect clients, which will reduce rather than increase accessibility to cleared derivatives markets for end-users. Such a decrease in accessibility would result in a less competitive market, with resultant increased costs for direct and indirect clients and concentration of systemic risk across a smaller number of entities.

The scale of the market upheaval – not least the requirement for clearing members and clients to repaper all indirect clearing arrangements at every level of the chain (i.e. many thousands of legal relationships) to accommodate the RTS (including structures which would be needed to meet the Article 5(8) obligations) – cannot be underestimated.

Therefore, it is imperative that a workable solution is found, in order to avoid undue market disruption and the risk of jeopardising the regulatory objective of access to markets, because the proposals as set out in the CP do seriously risk limiting access for ETD end users to global ETD markets and thereby reducing liquidity and increasing market risk.

A number of our concerns should be significantly ameliorated if the following key amendments are made:

- it should be clear that a clearing member may apply reasonable criteria (such as risk-based and/or commercial criteria) when deciding for which of its clients it is prepared to facilitate indirect clearing services;
- the application of the MiFIR RTS should be limited to clearing on an EU CCP of exchange traded derivatives entered into by an EU counterparty on an EU regulated market;
- each 'in-scope' entity in an indirect clearing arrangement should only be required to comply as far as practicable with its obligations under the MiFIR RTS (bearing in mind that there may be other entities in the chain that are not subject to MiFIR), should only have obligations in relation to the next person in the chain (subject to the porting or leapfrog requirements on clearing members) and should not be required to verify compliance with the RTS by other entities in the indirect clearing chain;
- clearing members should not be required to open more than one account of each type (i.e. NOSA/GOSA) at the CCP for holding the assets and positions of all of its indirect clients and similarly, other parties in the chain should not be obliged to maintain more than one account of each type (i.e. NOSA/GOSA) for indirect clients;
- requirements relating to porting should be removed or, if retained, they should be limited to GOSA structures and the "obligation of means" should be calibrated in such a way that it does not restrict the ability of clearing members to manage counterparty risk in the event of the default of a direct client; and
- requirements relating to Article 5(8) should be deleted, as they are not mandated by Level 1 and we strongly believe that these protections could be delivered through national or European legislation and may currently be available by choice through client asset regimes but that it is not feasible to outsource this task to individual entities in the chain of indirect clearing arrangements.

In addition, we are of the view that the requirements of the RTS should only apply to the first four parties in the clearing chain, to the extent that they are 'in scope' entities (and we note that a number of clarifications would be needed to address uncertainties in the RTS if this limitation is not adopted). We should also be grateful for guidance, possibly in the form of Q&A clarifying what is expected of clearing members in practice, in order to fulfil their "obligation of means" in respect of porting and leapfrog payments, if those requirements are not removed.

We consider that there are strong arguments to support the amendments outlined above, both from a practical perspective and also with regard to policy considerations and consistency with MiFIR. We have set out our reasoning in further detail below.

## **A. Scope**

It is very important that the MiFIR RTS include sensible scope parameters to ensure that they apply to indirect clearing arrangements with an appropriate EU nexus and that they will be workable in practice.

### *End indirect clients*

In our view the purpose of Article 30 MiFIR and the associated RTS is to provide protections to EU indirect clients and the scope of the RTS should be limited accordingly.

In our view, such a limitation would be consistent with ESMA's mandate under Article 30 MiFIR, to develop RTS "*ensuring consistency*" with the provisions under the EMIR RTS, as EMIR's Q&A OTC Q18 makes clear that the EMIR RTS is limited to entities subject to the EMIR clearing obligation, which has limited application to non-EU end clients.

### CCPs

We also consider that the MiFIR RTS should only apply in respect of ETDs cleared on an EU CCP and they should not seek to regulate third country CCPs' rules and arrangements for indirect clearing of exchange traded derivatives. To the extent such third country CCPs are recognised as a result of the equivalence process for third country CCPs established under EMIR and MiFIR, the "equivalent" rules of the third country would apply instead of the MiFIR RTS.

This is consistent with Level 1, as Article 30(1) MiFIR states that indirect clearing arrangements are permissible provided that the assets and positions of the counterparty benefit from protection with "*equivalent effect*" to that referred to in EMIR Articles 39 and 48. ESMA's EMIR Q&A CCP Q8(j) has clarified that the requirements of EMIR Article 39 apply only to EMIR authorised CCPs, whereas non-EU CCPs wishing to provide clearing services to EU clearing members or trading venues would instead be subject to the third country recognition procedure in Article 25 EMIR (including an equivalence assessment). The same principle should therefore apply in relation to the MiFIR RTS.

This also appears to be consistent with the broader territorial scope of MiFIR, which does not in general apply to third country CCPs. Instead, third country CCPs seeking access to an EU regulated market would be subject to the access provisions in Article 38 MiFIR, and a third country CCP clearing ETDs traded on an equivalent third country market would fall outside the scope of MiFIR altogether. A parallel can also be drawn with the clearing obligation under Article 29(1) MiFIR, which only seeks to impose the clearing obligation for ETDs on operators of (EU) regulated markets and not on operators of equivalent third country markets.

The scope of the RTS should be clarified accordingly.

### Trading venues

We are of the view that the MiFIR RTS should only apply in respect of ETDs that are subject to the clearing obligation under Article 29(1) MiFIR (i.e. ETDs that are traded on an EU regulated market) and not those ETDs that are traded on an equivalent third country market, even where those ETDs are cleared on an EU CCP.

Since MiFIR does not impose a clearing obligation on ETDs traded on an equivalent third country market, the MiFIR RTS should not seek to regulate how counterparties may clear those ETDs.

Indeed, it is very likely that counterparties trading ETDs on an equivalent third country market would be subject to the third country's rules relating to clearing of those ETDs, which may well be inconsistent with the requirements of the MiFIR RTS. For example, futures traded on ICE Futures US (assuming recognition as an equivalent third country market) and cleared through ICE Clear Europe would be subject to CFTC clearing rules, requiring clearing through Futures Commission Merchants ("**FCM**").

The scope of the RTS should be clarified accordingly.

Clearing members and clients – impact of 'mixed' (i.e. EU and non-EU entity) chains

Whilst the MiFIR RTS themselves do not include express scope provisions, Article 1 of MiFIR limits the application of Article 30 MiFIR (and therefore the MiFIR RTS) to:

- investment firms authorised under MiFID2 (Directive 2014/65/EU) and credit institutions authorised under CRD IV (Directive 2013/36/EU);
- financial counterparties and non-financial counterparties above the clearing threshold, in each case as defined in EMIR (Regulation 648/2012); and
- market operators including any (EU) trading venues they operate.

Therefore, a given indirect clearing structure may include some entities which are subject to the MiFIR RTS and other entities which are not subject to these requirements. Indeed, Article 2(1) of the MiFIR RTS expressly contemplates that an "equivalent third country credit institution or investment firm" may act as client in an indirect clearing structure. However, a non-EU client will not generally be subject to the requirements of the MiFIR RTS and will instead need to comply with, and may be subject to, their local laws, which may not be compatible with the MiFIR RTS.

In order to avoid undue market disruption, we consider that indirect clearing chains involving non-EU entities (such as a non-EU clearing member or client) must be "permissible". We note that it will not in general be possible for a clearing member or client to ensure that all other entities in the chain are compliant with the requirements set out in the MiFIR RTS. For example, a clearing member will not know the identity of each indirect client in the chain and whether or not any of those indirect clients are in turn providing indirect clearing services.

We do not think that it is ESMA's intention to require each entity that is subject to the requirements of the MiFIR RTS to verify or 'police' compliance by each other entity in the indirect clearing structure. Indeed, in our view, it should be sufficient (and therefore "permissible") for each entity in the clearing chain that is subject to the requirements of the MiFIR RTS to comply with its own obligations under the MiFIR RTS to the extent it is practical to do so, in light of performance by other parties in the chain with the requirements applicable to them and also bearing in mind that other entities in the indirect clearing chain may not be subject to these requirements. In addition, each party should only be obliged to look to the intermediate counterparty in the chain when complying with its requirements (save for, to the extent relevant and if not removed from the MiFIR RTS, porting or leapfrog payments).

We should be grateful for express clarification that this would be the case.

## **B. Number of separate accounts required**

In response to question 1 of the CP, we agree with the proposal for indirect clients to have a choice between an omnibus indirect account (NOSA) and gross omnibus account (GOSA) with collateral to be held at the CCP (other than additional collateral above the amount called by the CCP, which we agree should be treated in accordance with relevant contractual arrangements).

However, we do not agree with the proposal that a clearing member would be required to open a separate NOSA and/or GOSA at the CCP for holding the assets and positions of the indirect clients of each client in the indirect clearing chain (as required under Article 3(1) and Articles 5(1) and 5(4) of the draft MiFIR RTS).

This would give rise to an exponential proliferation of accounts down the chain, in a 'tree root' type structure, as illustrated in the attached diagram.



**Indirect Clearing  
Structure Di..**

The diagram shows the minimum numbers of accounts that would be needed under the MiFIR RTS for positions and assets of indirect clients – with each entity in the chain having only two immediate underlying clients. In addition to those shown, further accounts may be necessary in practice, for example separate accounts for assets which are / are not subject to national client asset protection regimes. Please note that the accounts for the proprietary positions and assets of clearing members and direct clients are not shown, in order to simplify the diagram.

Requiring such an account structure would multiply the necessary accounts and related operational processes, raising the complexity, cost and operational risk of indirect clearing obligations for all parties in an indirect clearing chain. This would also mean that indirect clients are afforded a greater level of segregation than direct clients of the clearing member, whose assets and positions could be recorded together with the other clients' assets and positions in a single omnibus account at the CCP.

*Proposed indirect client account structure – number of accounts required*

Instead, we consider that it should be sufficient for each clearing member to open a single account of each type (i.e. NOSA/GOSA) at the CCP for holding the assets and positions of all of its indirect clients. Although a clearing member may choose to open more accounts at the CCP, it should not be obliged to do so. This would reduce the operational burden associated with maintaining accounts at the CCP for holding assets and positions of indirect clients, including in relation to transfer of collateral. This would be consistent with the aim of the GOSA/NOSA structure, which was introduced as an operationally simpler choice of account structures, as per Recital 4 of the MiFIR RTS, in order to mitigate the increased complexity of indirect clearing, due to the greater number of entities between the CCP and end indirect client. This level of segregation is also consistent with paragraph 28 of the CP and Recitals 5, 11 and 12 of the MiFIR RTS. In particular, Recital 5 refers to "*ensuring a separation between the collateral and positions of the end indirect client and the collateral and positions of the client providing clearing services*".

Similarly, it should be sufficient at each level of the indirect clearing chain to have only a single account of each type (i.e. GOSA/NOSA) for indirect clients, where each end indirect client's choice of GOSA/NOSA is reflected all the way up the clearing chain (though each entity in the chain would maintain separate accounts for the assets and positions of its own direct clients). We note that having separate accounts for indirect clients at each level of the clearing chain would not enable parties further up the chain to identify each link in the chain down to a particular indirect client, as in general, parties will only know the identities of their direct clients.

Our proposed account structure is set out in the attached diagram.



**Indirect Clearing  
Structure Di..**

This approach would still provide sufficient information to allow allocation of value down the clearing chain to the correct underlying indirect clients in a default scenario, as each entity in the clearing chain will be able to separately identify the assets and positions of (a) each of its direct underlying clients; and (b) the indirect clients of each of its direct underlying clients.

We are of the view that our proposed account structure would be consistent with the constraints of Level 1, which permits indirect clearing arrangements that "do not increase counterparty risk".

For indirect clients that select the GOSA structure, we do not consider there to be a material difference from a risk perspective of the CCP (a) holding assets and positions of all indirect clients of a clearing member in a single GOSA; or (b) opening separate GOSAs for each client and indirect client who offers indirect clearing, to hold the assets and positions of their underlying clients. This is because positions will be recorded and margin called for on a gross basis and so it is very unlikely that a failing indirect client would be undercollateralised at the CCP – which is the only situation in which other indirect clients in the GOSA would be exposed to losses of the failing indirect client.

Indirect clients that select the NOSA structure will be subject to greater fellow client risk. If the CCP opens only one NOSA per clearing member, indirect clients may be exposed to losses connected to positions of a greater number of indirect clients than under the structure proposed in the draft MiFIR RTS. Whilst it is perhaps more likely in the 'single NOSA' structure that a particular indirect client will suffer loss due to the failure of another indirect client, any such loss would be spread across the greater number of indirect clients, reducing systemic risk. In addition, due to the greater level of netting achieved by a single NOSA, it is likely that more margin will be held at different levels of the indirect clearing chain rather than being passed higher up the chain towards the CCP and therefore being more likely to be held by or on the other side of a failing intermediary. The 'single NOSA' structure would also reduce the burden on clearing members, who are responsible to the CCP for making up any shortfalls. Both of these factors would have the effect of dissipating risk throughout the system. Therefore, overall we do not consider there to be a significant benefit from a risk perspective, or an overall reduction of counterparty risk, of the CCP (a) opening separate NOSAs for each client and indirect client who offers indirect clearing, to hold the assets and positions of their underlying clients, compared to (b) holding assets and positions of all indirect clients of a clearing member in a single NOSA.

*GOSA offering - standardisation*

The MiFIR RTS introduce a new type of GOSA account, which is not currently widely used in the ETD market, and impose requirements as to the functionality associated with such account. Whilst we generally agree with the NOSA/GOSA choice of account structures proposed, there will be implementation challenges as CCPs, clearing members

and clients will need to develop systems and procedures to support this new account functionality.

We are concerned that if CCPs respond to the MiFIR RTS with a vast array of account types and approaches to indirect clearing, this will increase the implementation burden across the market. This burden is likely to fall particularly heavily on smaller industry participants, who may be clients of clearing members. As highlighted in the EMIR review, such inter-CCP variation was a feature of EMIR ISA implementation and has had a real impact on client appetite for such accounts, largely due to the complexities inherent in ISA structures which vary on a per CCP basis. It is our view that simpler, more prescriptive segregation rules for GOSA indirect clearing accounts would lead to more standardised and efficient implementation by CCPs, which would in turn offer a more consistent choice of account segregation options to clients. By way of example, the US's highly prescriptive "legally segregated, operationally commingled" (LSOC) model is perceived to have worked well to deliver standardisation across the market, helping to reduce the implementation burden on market participants. We would therefore ask ESMA to work with the industry to set standardised requirements for the required GOSA account types, in order to help minimise the implementation burden for indirect clearing arrangements.

### **C. Default management process – porting**

In response to question 2 of the CP, we have significant concerns in relation to the re-introduction of provisions on porting in the MiFIR RTS.

In addition to the legal issue that porting is highly susceptible to challenge under local insolvency laws, which cannot be overridden by the RTS, there are a number of practical issues that mean it is extremely unlikely that a clearing member would successfully be able to port the assets and positions of indirect clients from a defaulting client to another client, including the need for all indirect clients to request porting and have arrangements in place with the same backup client and the very slim likelihood of finding a willing backup client which is prepared to accept the full defaulted direct client's portfolio of indirect clients in what would necessarily be an extremely compressed timeframe. Further, in our view, putting procedures in place to trigger porting may be misleading to indirect clients, as it may lead indirect clients to expect that porting could occur in circumstances where it is impossible or at least highly unlikely to occur.

By introducing an "obligation of means" rather than requiring a particular outcome, we understand ESMA has attempted to take into account the significant legal and practical problems surrounding porting that have previously been highlighted to ESMA, not least the susceptibility of porting to legal challenge under local insolvency and/or property laws, whilst taking account of Level 1 provisions.

In particular, we understand that when re-introducing provisions on porting in the MiFIR RTS, ESMA may have had in mind Article 30 MiFIR, which provides that permissible indirect clearing arrangements developed under the RTS must *"ensure that the assets and positions of the counterparty benefit from protection with equivalent effect to that referred to in Articles 39 and 48 of [EMIR]"* and ensure *"consistency with the provisions established for OTC derivatives under Chapter II of [EMIR]"*.



However, we consider that the "obligation of means" would still impose a significant burden on clearing members to put in place relevant procedures that could in theory achieve porting, even though the likelihood of those procedures being successful in the event of a client default is very remote. Further, it is not clear from the MiFIR RTS or CP exactly what clearing members would be expected to do in order to satisfy this "obligation of means".

Given that the majority of exchange traded derivatives markets are liquid, involving standardised products, an indirect client should generally be able to close out and re-establish its exchanged traded derivatives positions in the event of a client default. This should have an equivalent effect to the transfer of the indirect client's positions to an alternative client. Moreover, the potential benefits to an indirect client of prompt liquidation are dramatically in excess of the potentially significant costs of any delay in the close-out process as a result of a clearing member complying with its "obligation of means" to establish the feasibility of porting prior to concluding, in all likelihood, that it cannot port and should close-out the positions.

Limitation or removal of the porting requirements would reduce the need for such a delay in the close-out process, during which counterparties would be exposed to market risk before initiating the liquidation of positions. Given the very remote likelihood of porting being successful in the default of the client, we consider that limitation or removal of the porting requirements would therefore minimise risk and provide better protection for the counterparty. This is acknowledged at paragraph 38 of the CP, which notes that the speed with which positions can be liquidated can contribute to minimising any loss on the liquidation of these positions and collateral.

In addition, requiring clearing members to delay close-out whilst they trigger porting procedures restricts their ability to manage the risk associated with a default and exposes them to counterparty risk at a time of potential stress. Clearing members do not have many of the legal and structural protections available to CCPs in order to manage the risk associated with a default, such as the waterfall process and availability of a default fund. CCPs may also be protected from certain types of insolvency or property law challenges, such as in relation to preferences, whereas clearing members do not benefit from equivalent protections. At the time a porting decision is made, a clearing member would need to be effectively certain that the actions they take to port positions and/or assets will not be subject to insolvency or property law challenge at the time, or in the future. However, due to the lack of protections for clearing members in a porting scenario, clearing members would not generally have the necessary legal certainty as to the outcome of steps they may take to port positions. Clearing members should not be required to effectively act as a CCP by being required to trigger onerous porting procedures when they do not have these protections.

We think that it should be possible to achieve consistency with Level 1 without introducing requirements relating to porting or by reducing the burden of any such requirements to a minimum. Further, it is our view requirements with respect to porting potentially contradict the requirement in Article 30(1) MiFIR and reflected in recital (1) of the RTS that an indirect clearing arrangement should not expose a CCP, clearing member, client or indirect client to additional counterparty risk. On this basis, and in light of the significant legal and practical difficulties with porting, we consider that the requirements relating to porting in the MiFIR RTS should be removed or limited to apply to GOSA structures only (on the

basis that likelihood of porting being successful is even lower for NOSA structures) and the burden of such requirements reduced to a minimum. We consider that it is within the scope of ESMA's mandate under MiFIR to do so.

ESMA acknowledges at paragraph 36 of the CP that the MiFIR RTS cannot override third country insolvency regimes, which may prohibit porting on the basis that it bypasses an insolvency administrator of a defaulting intermediary entity. In addition, in the absence of a harmonised European insolvency regime, porting may be challenged by an insolvency administrator of a defaulting EU intermediary entity. Even where the defaulting entity is not insolvent at the time of porting, there may be a risk that porting could be unwound at a later date, for example as a preference under future insolvency proceedings. National property law challenges might also arise, for example for theft, breach of trust or conversion, against a clearing member that seeks to port and, again, neither EMIR, MiFID2/MiFIR nor the MiFIR RTS purports to over-ride national property laws. Therefore, clearing members should not be required to port in circumstances where they may be exposed to challenge under national insolvency or property laws.

There may also be circumstances in which porting may be technically possible, but disproportionately time consuming and costly, and therefore contrary to the interests of underlying clients. Therefore, the rules relating to porting, if not removed, should be sufficiently flexible to allow clearing members to manage risks arising from a default in a proportionate manner. For example, clearing members should only be required to make reasonable efforts to port client positions and should be able to define the length of the "transfer period" under Article 4(7) of the MiFIR RTS in a way that retains sufficient flexibility to allow the clearing member to take into account factors such as market volatility, bearing in mind the increased market and counterparty risk that would result from an undue delay in close-out and liquidation of positions.

If the porting requirements are not removed altogether, we request that ESMA provides clarification as to what is required of clearing members in relation to triggering porting procedures under Article 4(7) of the MiFIR RTS, perhaps by way of non-exhaustive examples of what ESMA expects a clearing member to do or a non-exhaustive list of reasons why clearing members may determine that it is not feasible to port in a particular situation. Any such requirements should be sufficiently flexible to allow the clearing member to manage the risks of a default scenario appropriately – otherwise, the MiFIR RTS will have the effect of increasing counterparty risk. We think it may be most appropriate for such clarification to be made by way of Q&A, published at or around the same time as the MiFIR RTS and the industry would be happy to discuss proposals in advance of ESMA publishing any Q&A.

#### **D. Default management process – leapfrog payments**

Continuing our response to question 2 of the CP, ESMA also introduces an "obligation of means" on clearing members in relation to making leapfrog payments to indirect clients, at Article 4(7) of the RTS. We welcome the clarification that this requirement applies in respect of GOSA arrangements only.

However, we consider that it will be important to have more certainty over what is sufficient for clearing members to satisfy this "obligation of means" to try to make leapfrog payments.

ESMA acknowledges at paragraph 36 of the CP that the MiFIR RTS cannot override third country insolvency regimes, which may prohibit the making of leapfrog payments which bypass an insolvency administrator of a defaulting intermediary entity. In addition, in the absence of a harmonised European insolvency regime, a leapfrog payment may be challenged by an insolvency administrator of a defaulting EU intermediary entity. Even where the defaulting entity is not insolvent at the time of making a leapfrog payment, there may be a risk that leapfrog payments could be unwound at a later date, for example as a preference under future insolvency proceedings. National property law challenges might also arise, for example for theft, breach of trust or conversion, against a clearing member that seeks to port and, again, neither EMIR, MiFID2/MiFIR nor the MiFIR RTS purports to over-ride national property laws. Therefore, clearing members should not be required to make leapfrog payments in circumstances where they may be exposed to challenge under national insolvency or property laws.

Clearing members may also be exposed to a risk of legal challenge from indirect clients for other reasons, for example due to the clearing member being provided with incorrect information about indirect clients' entitlements or as a result of the clearing member's attempt to allocate shortfalls between indirect clients. Clearing members should be able to take into account the risk of these other potential legal challenges when determining whether or not to make a leapfrog payment.

In addition to conflicts with insolvency laws and the risk of legal challenge, a clearing member may be unable to make a leapfrog payment to a client as a result of other reasons, such as AML or sanctions requirements – either because it has been unable to obtain necessary information about indirect clients or because the results of its checks raise concerns from an AML or sanctions perspective.

We note that the RTS do not indicate that a clearing member is expected to conduct customer due diligence on all indirect clients in a chain upfront, nor do we think it would be appropriate to expect a clearing member to do so. However, this means that a clearing member may have a small window following a client's default to carry out customer due diligence, including assessments such as AML and sanctions checks. Further, this assumes the clearing member has the necessary information to conduct such due diligence, which is doubtful if the direct client has entered insolvency proceedings (notwithstanding Article 5(9) of the RTS, which is very difficult to implement in practice). It is not currently clear what level of due diligence a clearing member would be required to conduct in order to obtain necessary information about the indirect clients and at what point in time (i.e. pre- or post-default of its direct client) it would be required to conduct this due diligence. However, in any event it is likely that the threshold will not be met and the leapfrog payment will consequently be impracticable.

We therefore request that ESMA provides clarification as to what is required of clearing members in relation to leapfrog payments under Article 4(7) of the MiFIR RTS, perhaps by way of non-exhaustive examples of what ESMA expects a clearing member to do or a non-exhaustive list of reasons why clearing members may determine that it is not feasible to make a leapfrog payment in a particular situation. Any such requirements should be sufficiently flexible to allow the clearing member to manage the risks of a default scenario appropriately – otherwise, the MiFIR RTS will have the effect of increasing counterparty risk. We think it may be most appropriate for such clarification to be made by way of Q&A,

published at or around the same time as the MiFIR RTS and the industry would be happy to discuss proposals in advance of ESMA publishing any Q&A.

#### **E. Default management process – Article 5(8)**

As the final point in our response to question 2 of the CP, we have significant concerns in relation to Article 5(8) of the draft MiFIR RTS, under which clients are required to ensure that any payments made to them for the account of an indirect client do not form part of the client's insolvent estate. In contrast to the "obligations of means" on clearing members relating to porting and leapfrog payments under the draft MiFIR RTS, Article 5(8) appears to introduce a strict requirement as to the outcome.

Absent statutory or other local law protections, this would require each client or indirect client offering indirect clearing services to analyse its position under local insolvency laws and put in place bespoke contractual arrangements to achieve the required outcome. Whilst this may be technically possible in some jurisdictions, it has not yet been tested and the technical legal analysis and corresponding solution will depend on each jurisdiction and type of entity involved, which would be a huge undertaking across the industry as a whole. Further, it will not be possible to achieve a uniform, scalable solution. This is, in substance, exactly the same problem as the industry has been grappling with in relation to implementation of the porting and leapfrog requirements in the existing EMIR RTS on indirect clearing, a problem which it is acknowledged by industry and regulators alike, is not reasonably surmountable.

We consider that the time and cost required for each client or indirect client offering indirect clearing services to devise and implement a bespoke solution would be prohibitive and is likely to make it uneconomical for many current providers of indirect clearing services to continue to do so. Ultimately, this is likely to restrict access to clearing for end users.

We also note that this requirement goes beyond Article 48(7) EMIR, which requires that where there has been neither porting nor leapfrog payment, any remaining balance owed after completion of the CCP's default management process shall be returned "*to the clearing member for the account of its clients*". It does not require the clearing member to ensure that any such proceeds it receives do not form part of the clearing member's insolvency estate. An equivalent requirement to Article 48(7) EMIR is already contained at Article 4(7) of the MiFIR RTS. We do not consider that ESMA is mandated to expand the Level 1 requirements and so believe that deletion of Article 5(8) of the draft MiFIR RTS would be consistent with Level 1 and ESMA's mandate.

We strongly believe, in any event, that the protections envisaged by Article 5(8) can be delivered through national or European legislation and may currently be available by choice through client asset regimes. The Commission could consider an extension to client asset regimes in the EU if it felt there was a need to do so in order to improve the current level of protection of clients' assets and positions in indirect clearing structures and ensure a uniform level of protection across the EU. It is not feasible, however, to outsource this task to individual entities in the chain of indirect clearing arrangements.

#### **F. Longer chains**

We understand ESMA's intention in bringing longer chains (i.e. clearing chains which involve entities that receive ETD clearing services from indirect clients) within scope of the RTS is to deliver protections down to the end indirect client. However, this introduces a number of additional complexities and uncertainties which could be particularly problematic for existing longer chains in the ETD market.

In general, applying the MiFIR RTS requirements to longer chains will have the effect of exacerbating the other general issues that apply to a four party chain, by virtue of the greater number of parties involved and exponential growth in the number of accounts required. It also becomes more likely that one or more of the parties in the chain is a non-EU entity which may be subject to conflicting laws and regulations, and the greater degree of separation between the CCP and end indirect client make operational issues such as information flows more difficult. Therefore, applying the requirements of the MiFID RTS all the way down a longer chain becomes disproportionately burdensome from a practical, legal and operational perspective and so we strongly believe that, whilst longer chains should be permissible, the requirements of the MiFIR RTS should be limited to the first four parties in the chain.

In addition to the legal and other reasons set out elsewhere in this response, there are critical operational and systemic risk reasons why the requirements of the MiFIR RTS should be limited to the first four parties in the chain, as follows:

1. For CCPs, applying the requirements of the MiFIR RTS in respect of unlimited chains would significantly increase the operational burden and risk of errors arising through associated processes. The heightened operational complexity created by multiplying account structures and increasingly complex margin arrangements will result in significantly increased operational risk and costs, the outcome of which will be that clients' assets will be less likely to be in the right place at the right time. This risk would be significantly mitigated if the MiFIR RTS requirements were limited to the first four parties in a chain. Without that limitation, in the event of a default at any level in an indirect clearing chain, the default management process will be delayed through inevitable asset-tracing challenges and claims / counter-claims that will be complex to unwind.

By way of example, longer indirect clearing chains where all parties are subject to the MiFIR RTS requirements would have the following impact on the number of necessary reconciliations for a GOSA:

- a. for a single GOSA in respect of all GOSA indirect clients of a clearing member, where indirect clients are limited to the fourth party in the chain, only one additional reconciliation would be required;
- b. if a GOSA is required for indirect clients on a per direct client basis:
  - i. with no obligation to distinguish beyond the indirect client of that direct client, the number of additional sets of reconciliations required would equal the number of each CM's direct clients offering indirect clearing arrangements; or

- ii. if each indirect client's house and indirect clients' positions and collateral value must be distinguished, the number of additional reconciliations required is unlimited and the increased operational risk cannot be overstated.

The same number of reconciliations would be required again in respect of each NOSA.

Consequently, the impact of (a) longer chains and (b) requiring clearing members and CCPs to segregate indirect clients' assets and positions at each different level of the chain would, together, have a significant impact on necessary reconciliations, which would increase clearing costs and complexities (and associated operational risk) with limited meaningful benefit for end-users, as described in further detail elsewhere in this response.

2. In addition, for indirect clearing chains which exceed four parties, the clearing member would need to apply collateral requirements to an increasingly complex set of indirect client relationships through the indirect clearing chain, in the context of the accounts and other structures proposed in the MiFIR RTS.

Operational risks associated with resolution of breaks or similar issues requiring coordination of all participants in the chain would also significantly increase where the chain extends to more than four parties. Further, since the identity of the indirect client would not be known to the clearing member, there would be only limited scope to resolve any such issues between the parties and to effectively identify such breaks in the first instance.

It will also be particularly challenging to determine required excess margin for each relevant indirect client in a longer chain, when excess margin must be determined on a highly dynamic basis with respect to changing IM and VM requirements. We have concerns as to how relevant information could be provided in a sufficiently timely manner within a chain which involves more than four parties. In order to address these concerns, it is likely clearing members would require the direct client to hold substantial additional margin to effectively pre-fund the margin calls of its underlying clients, and so on down the chain. This would add materially to the cost of access to clearing for all clients in the chain.

There are also ambiguities as to how the requirements of the MiFIR RTS would apply in the context of longer chains. Taking the following five party chain as an example, and assuming for simplicity that all parties are established in the EU, references in the MiFIR RTS to 'indirect client' may refer to either or both of IC1 and IC2 and references to 'client' in Article 5(2) to 5(8) of the MiFIR RTS will refer to Client or IC1, depending on the context.



This gives rise to the following uncertainties:

1. It is not always clear whether references to 'indirect client' would refer to either or both of IC1 and IC2 in the chain set out above. For example, whilst we understand references

to 'indirect clients' at Article 4(2) to (5) to refer to all indirect clients, in our view, the default management procedures at Article 4(7) should apply only in the event of Client's default and so references to 'indirect client' in Article 4(7) should refer only to IC1. Indeed, CM should not be expected to make a leapfrog payment to IC2 in the event of a default by Client and ICI. This uncertainty would be clarified by limiting the requirements of the MiFIR RTS to the first four parties in a chain.

2. In relation to Article 5, we believe that these requirements are intended to apply to each 'client-indirect client' pair separately, all the way down the chain (i.e. to the 'Client-IC1' and 'IC1-IC2' pairs in the example above). In addition, we assume that the intention is for intermediate indirect clients to comply with Articles 5(3) and 5(4) by passing information and requests up the chain to the clearing member, rather than, for example, requiring an intermediate indirect client to directly request the clearing member to open an account at the CCP under Article 5(4). In this example, the clearing member's obligations would apply only vis-a-vis Client. Therefore, IC2 would need to pass any instructions, margin etc. up the chain via IC1 and Client and clearing member would not be required to differentiate between IC2 and any other indirect client it may have in respect of either Client or any other direct client. We consider that it will be extremely challenging to develop rules that clearly and consistently set out how these obligations apply at each level of a longer chain. Therefore we believe that limiting the application of the MiFIR RTS to the first four parties in the chain is the most practical solution and should increase certainty.

Therefore, in light of the legal uncertainties introduced by seeking to apply the requirements of the RTS all the way down longer chains and greatly increased operational difficulties in complying with the requirements of the RTS for longer chains, we consider that an indirect clearing arrangement should be "permissible" provided that the first four parties in the chain comply with the requirements of the RTS where applicable (i.e. where the relevant party is subject to the RTS), even if the chain contains more than four parties. This should still give increased protections to indirect clients using longer chains, who may also still benefit from protections afforded by national client asset regimes, whilst providing a more practicable solution than applying obligations on 'clients' all the way down the chain.

## **G. Other issues**

1. A clearing member should be able to apply reasonable criteria when deciding for which of its clients it is prepared to facilitate indirect clearing services, such as risk-based and/or commercial criteria. For example, a clearing member may decide that it is only prepared to facilitate provision of indirect clearing services for affiliates. The ability of clearing members to exercise their contractual freedom in this way should be clearly reflected in the MiFIR RTS. Article 2(1) of the MiFIR RTS should be amended accordingly.
2. Risk management obligations imposed on the clearing member under Article 4(8) of the MiFIR RTS need to be workable, clear, fair and comparable with the risk management obligations imposed on CCPs under Article 3(3) of the MiFIR RTS.
3. The operational and implementation challenges are particularly problematic because the requirements are due to come into force on a single date, impacting all existing indirect clearing arrangements. This 'big bang' approach would be very challenging for

market participants to implement internally across the various CCPs; and similarly problematic for CCPs who would need to move to RTS-compliant structures for all their clearing members on a single date. In order to avoid undue market disruption, an appropriate phase-in period will be needed, to allow sufficient time for existing indirect clearing structures to be amended as necessary to comply with the requirements of the RTS.

## H. Cost benefit analysis

1. As noted above, this response takes into account the views of a working group of FIA Europe's members, including firms which may act as clearing member or client in ETD indirect clearing structures and also some CCPs.

We provide an illustration of the significant proportion of ETD clearing which is currently done "indirectly", with the exception of client to client clearing for which we do not have available data, in the table below. The data was collated last year by FIA Europe from responses received from member firms in the context of the MiFID II Discussion Paper, but remains pertinent to the cost benefit analysis in relation to the current CP. The figures shown are an average of the data provided by 5 member firms in relation to them and their group companies. The data gathered has been ordered to focus on whether the main EU group entity is a member of the relevant CCP.

	Exchange memberships	Total number	Volumes cleared
1.	Exchange memberships of group (direct or indirect) globally	38	100%
2.	Exchange memberships where an EU group entity is the member	13	48%
3.	Relationships for which the main EU group entity is not a member in the relevant market and therefore a third party clearing member is used to provide access to the relevant market	13	2%
4.	Relationships for which the main EU group entity is not a member in the relevant market and therefore affiliates are used to provide access to the relevant market	17	50%

It is clear from the figures above that a substantial volume of clearing in relation to ETD is done indirectly. Any clearing done through an affiliate or non-affiliate, as shown in rows 3 and 4 above, would be directly affected by the MiFIR RTS. It is also worth noting that the five firms represented in the sample are major clearing brokers. Smaller brokers may have even less direct access to clearing venues and, therefore, data for that group of industry participants (if it were included in the sample) would likely show a much greater percentage in row 3 of the table.

2. It is very difficult to quantify the expected costs and benefits from complying with the MiFIR RTS at this stage. However, we are concerned that the operational costs and complexities that would be introduced by the MiFIR RTS in their current form are likely to outweigh the potential benefits of the requirements. This analysis has driven



the identification of the key amendments that we have proposed making to the MiFIR RTS, as set out in this response.

In particular:

- a. Requiring a clearing member to open a separate NOSA and GOSA at the CCP for holding the assets and positions of the indirect clients of each client in the indirect clearing chain would give rise to an exponential proliferation of accounts down the chain, in a 'tree root' type structure. Requiring such an account structure would multiply the necessary accounts and related operational processes, raising the complexity, cost and operational risk of indirect clearing obligations for all parties in an indirect clearing chain. However, we do not consider that it would deliver any significant benefit from a risk perspective as compared with the alternative account structure proposed in our response, whereby clearing members should not be required to open more than one NOSA and GOSA at the CCP for holding the assets and positions of all of its indirect clients (although it may choose to do so) and similarly, other parties in the chain should not be obliged to maintain more than a single NOSA and GOSA for indirect clients.
- b. In relation to porting and leapfrog payments, we consider that the "obligation of means" would still impose a significant burden on clearing members to put in place relevant procedures that could in theory achieve porting and/or leapfrog payments, even though the likelihood of those procedures being successful in the event of a client default is very remote. Requiring a huge operational lift by the market for purposes of establishing a structure which in practice is unlikely to achieve the relevant outcome, would be disproportionate from a cost benefit analysis. Therefore, it is important that these obligations are limited to GOSA structures (or removed altogether in the case of porting) and that in relation to any remaining "obligation of means", clearing members are only expected to take actions that are reasonable and proportionate to the expected outcome.
- c. Notwithstanding that we believe Article 5(8) of the MiFIR RTS is not mandated by Level 1, we consider that the time and cost required for each client or indirect client offering indirect clearing services to devise and implement a bespoke solution to comply with the requirements of Article 5(8) of the MiFIR RTS would be prohibitive and is likely to make it uneconomical for many current providers of indirect clearing services to continue to provide those services.
- d. The requirements of the MiFIR RTS should only apply to the first four parties in the clearing chain, to the extent that they are 'in scope' entities. This is because, in general, applying the requirements of the MiFIR RTS to longer chains will have the effect of exacerbating the other general issues that apply to a four party chain, by virtue of the greater number of parties involved and exponential growth in the number of accounts required. It also becomes more likely that one or more of the parties in the chain is a non-EU entity which may be subject to conflicting laws and regulations, and the greater degree of separation between the CCP and end indirect client make operational issues such as information flows more difficult and subject to increased operational and systemic risk. Therefore, applying the requirements of the MiFIR RTS all the way down a

longer chain becomes disproportionately burdensome, from a practical, legal and operational perspective.

3. Given our experience of implementation of direct client clearing requirements under EMIR, we anticipate the costs of compliance with the MiFIR RTS to be very high.
4. We are concerned that if the MiFIR RTS are adopted in their current form, this could result in a decline in market participants' willingness to engage in indirect clearing arrangements in light of the resultant operational, legal, re-papering, business, capital and compliance requirements. Operational costs and complexities entailed by the requirements of the MiFIR RTS may not be operationally supportable by all clearing members and their clients currently providing market access to indirect clients, which will reduce rather than increase accessibility to cleared derivatives markets for end-users.

Such a decrease in accessibility would result in a less competitive market, with resultant increased costs for direct and indirect clients and concentration of systemic risk across a smaller number of entities. This is also likely to lead to a significant reduction in market liquidity and indirect clients whose market access is restricted would be prevented from employing effective hedging strategies.

5. As noted above, more than 50% of existing global ETD activity involves clearing where the ultimate client is not in a direct relationship with the ultimate clearing member. These ETD indirect clearing arrangements enable end clients to access global markets in order to effectively and economically manage their risk. Therefore, if the significant legal and practical challenges posed by the current draft MiFIR RTS are not solved, the scale of potential upheaval of the existing ETD market cannot be underestimated.

## Part II: Revised Draft



**MiFIR draft RTS  
on indirect cl..**

## Part III: Commentary Table

<b>Provision</b>	<b>Summary of FIA Europe and IA Amendment(s)</b>	<b>Explanation</b>
Recital 1	Clarify that indirect clearing arrangements outside the scope of the RTS are not prohibited	Our amendments to Article 1 and inclusion of Article 1a propose sensible scope parameters for the RTS. The amendment to Recital 1 clarifies that indirect clearing arrangements that fall outside the suggested scope parameters (for example, indirect clearing arrangements on non-EU CCPs) are not subject to the requirements of the RTS, nor are they prohibited by the RTS.

Recital 8 (now Recital 9)	Removal / limitation of porting requirements	We have proposed either removing porting requirements or limiting the requirement for a clearing member to have procedures to facilitate porting to GOSA structures and increasing the flexibility of the requirements, due to the significant legal and practical difficulties with porting. See comments at Article 4(7) for further details.
Recital 10 (now Recital 11)	Deletion of Article 5(8)	We propose deleting Article 5(8) as it goes beyond the requirements at Article 48(7) EMIR, and so is not required under Level 1. See comments at Article 5(8) for further details.
Articles 1 and 1a	<p>1. Limitation of scope of RTS to (a) EU CCPs and (b) EU indirect clients and (c) EU clients.</p> <p>2. Clarification that the RTS apply solely to the first four parties in an indirect clearing arrangement (i.e. CCP, clearing member, client, indirect client).</p>	<p><u>1. Scope parameters</u></p> <p>It is important that the RTS include sensible scope parameters to ensure that (i) they apply to indirect clearing arrangements with an appropriate EU nexus; and (ii) they will be workable in practice.</p> <p>Whilst the scope of the MiFIR RTS will generally be determined by the scope provisions at Article 1 MiFIR, there are a number of additional clarifications to the scope of the MiFIR RTS that we would encourage ESMA to include in the operative provisions of the RTS themselves, rather than in accompanying Q&amp;A.</p> <p>The clearest and most effective way to achieve the above objectives would be to limit the application of the RTS to arrangements involving exclusively EU parties. The greater the extent to which the RTS can be limited to EU parties, the more likely it is that parties subject to the RTS can comply with the requirements therein. ESMA acknowledges in the CP the likelihood that the RTS will create conflicts of law that cannot be overridden by the RTS.</p> <p>We would expect such conflicts to be most likely to arise with respect to third countries (such as the United States) which may have insolvency regimes specifically designed to deal with the failure of brokers, for example.</p> <p>As a minimum, we would suggest that the scope of the RTS is limited to indirect clearing arrangements for ETDs executed on an EU regulated market, involving (i) CCPs established in the European Union and (ii) indirect clients established in the European Union. We would also ask ESMA to consider limiting the application of the RTS to EU clients.</p> <p><u>(a) Limitation to EU CCPs</u></p> <p>We propose limiting the RTS to EU CCPs (achieved through our proposed amendment to the definition of “indirect clearing arrangement”) on the following bases:</p>

		<ul style="list-style-type: none"> <li>• Consistency with MiFIR: Article 30(1) MiFIR states that indirect clearing arrangements are permissible provided that the assets and positions of the counterparty benefit from protection with “equivalent effect” to that referred to in EMIR Articles 39 and 48. ESMA EMIR Q&amp;A CCP Q8(j) has clarified that the requirements of EMIR Article 39 apply only to EMIR authorized CCPs.</li> <li>• Policy rationale and enforcement: we consider it important from a policy and enforcement perspective that the RTS are given a sufficient EU nexus and do not purport to regulate arrangements relating to non-EU CCPs.</li> </ul> <p><u>(a) Limitation to ETDs traded on an EU regulated market</u></p> <p>We propose limiting the RTS to ETDs traded on an EU regulated market (achieved through Article 1a) on the following bases:</p> <ol style="list-style-type: none"> <li>1. Consistency with MiFIR: Article 29(1) MiFIR imposes a clearing obligation only on those ETDs that are traded on an EU regulated market. Therefore, the MiFIR RTS should not seek to restrict how parties may clear those ETDs that are not subject to a clearing obligation under MiFIR.</li> <li>2. Policy rationale and enforcement: we consider it important from a policy and enforcement perspective that the RTS are given a sufficient EU nexus and do not purport to regulate arrangements relating to clearing of ETDs traded on a non-EU market.</li> </ol> <p><u>(b) Limitation to EU indirect clients</u></p> <p>We propose limiting the RTS to indirect clients established in the EU (covering entities incorporated in the EU and not, for instance, EU branches of non-EU firms) on the following bases:</p> <ul style="list-style-type: none"> <li>• ESMA’s mandate under MiFIR: ESMA is directed to develop RTS “ensuring consistency” with the provisions under the EMIR RTS. EMIR Q&amp;A OTC Q18 limits the scope of the EMIR RTS to entities subject to the EMIR clearing obligation, which has limited application to non-EU end clients. Therefore the proposed limitation in scope to EU indirect clients would ensure consistency with the EMIR RTS.</li> <li>• We believe the rules are ultimately aimed at providing protection for EU end users.</li> </ul>
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		<ul style="list-style-type: none"> <li>• It would be difficult to articulate a coherent policy rationale for regulating essentially non-EU clearing chains where the only EU nexus is the EU CCP, which itself could be a US Derivatives Clearing Organisation (for example: ICE Clear Europe – US FCM – US client – Brazilian indirect client).</li> </ul> <p><u>(c) Limitation to EU clients</u></p> <p>We would also ask ESMA to consider limiting the RTS to EU clients. The rationale set out above with respect to the limitation to EU indirect clients applies equally in respect of a limitation to EU clients. We would also note that many of the conflicts of law issues expected to arise (and render significant indirect clearing activity non-compliant) are likely to relate to the insolvency law applicable to the client. The RTS are not able to address or override foreign laws or national EU insolvency or property laws. Accordingly, the RTS are significantly more likely to be workable in practice and avoid disruption to (and potentially cessation of) global, cross-border indirect clearing arrangements if their application is limited to EU clients. Additional disclosure requirements could be introduced to ensure that EU indirect clients receiving indirect clearing services from non-EU clients are made sufficiently aware of the attendant risks and of the additional protections that could be available by clearing through an EU client.</p> <p><u>2. Arrangements with more than four parties ("longer chains")</u></p> <p>Our suggested amendment provides that the first four parties in any indirect clearing arrangement must always comply with the RTS applicable (i.e. where the relevant party is subject to the RTS), even if the chain contains more than four parties.</p> <p>In general, longer chains will also have the effect of exacerbating the other general issues that apply to a four party chain, by virtue of the greater number of parties involved. For example, it becomes more likely that one or more of the parties in the chain is a non-EU entity which may be subject to conflicting laws and regulations, and the greater degree of separation between the CCP and end indirect client make operational issues such as information flows more difficult.</p> <p>In light of the increased operational and legal difficulties in complying with the requirements of the RTS for longer chains, we consider that an indirect clearing arrangement should be "permissible" provided that the first four parties in the chain comply with the requirements of the RTS, even if the chain contains more than four parties. This should still</p>
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		give increased protections to indirect clients using longer chains, whilst providing a more practicable solution than applying obligations on 'clients' all the way down the chain.
Article 2(1)	Clarification that clearing member may offer indirect clearing services to certain clients only and that the clearing member may apply objective, risk based criteria when determining whether to facilitate indirect clearing services for a client	<p>The proposed amendment clarifies that a clearing member may decide to facilitate indirect clearing services for some, but not all, of its clients, subject to reasonable commercial terms (which must be publicly disclosed under Article 4(1)). A clearing member might deem certain clients to be suitable to support indirect clearing (whether on risk, legal or commercial grounds) and others not. For example, a clearing member may decide that it is only prepared to facilitate provision of indirect clearing services for affiliates.</p> <p>We believe it is important to clarify that clearing members have the ability to exercise contractual freedom in this manner, as Article 2(1) currently suggests otherwise.</p> <p>However, we do not believe that that there is a regulatory intention to make it mandatory for clearing members to facilitate indirect clearing or prevent clearing members from exercising their reasonable judgement when determining whether or not to facilitate indirect clearing services for a particular client. Therefore, we do not expect this amendment to be controversial.</p>
Article 2(2)	Expansion of requirement to consult with clearing member on contractual terms	<p>We believe the reference to "<i>aspects that can impact the operations of the clearing member</i>" may not be sufficiently broad to capture other key areas where the clearing member will require consultation on the contractual terms between the client and the indirect client to ensure it is able to comply with the RTS. For example, the clearing member may need to be consulted on the manner in which it receives information from the client relating to the risks from indirect clearing arrangements with particular indirect clients in order to fulfil its obligations under Article 4(8). Our suggested amendment ensures that there will be an appropriate dialogue between key parties before indirect clearing arrangements are entered into.</p> <p>We have also reflected the limitation of the requirements of the RTS to the first four parties in the chain.</p>
Articles 3(1), 4(2) and 4(5)	Limiting the number of different accounts at the CCP for holding indirect clients' assets and positions to one NOSA and/or GOSA per clearing member	<p>We consider that it should be sufficient for each clearing member to open a single NOSA and/or GOSA at the CCP for holding the assets and positions of all of its indirect clients. This would be consistent with the aim of the GOSA/NOSA structure, which was introduced as an operationally simpler choice of account structures, as per Recital 4 of the MiFIR RTS, in order to mitigate the increased complexity of indirect clearing, due to the greater number of entities between the CCP and end indirect client.</p>

		In our view, requiring a clearing member to open a separate NOSA and/or GOSA at the CCP for holding the assets and positions of the indirect clients of each client in the indirect clearing chain would multiply the necessary accounts and related operational processes, raising the complexity, cost and operational risk of indirect clearing obligations for all parties in an indirect clearing chain, but would not provide any significant benefit from a counterparty risk perspective.
Article 4(1)	Clarification to limit requirements to first four parties in the chain	Clarification to limit the requirements of the RTS to the first four parties in the chain.
Article 4(3) and Article 5(3) (now Article 5(2))	Clarification regarding record keeping	<p>Clarification for consistency with Article 4(2)(b) that the records will show the collateral value <i>after applying any agreed haircut</i>.</p> <p>Margin should be so treated if "<i>attributable to</i>" the indirect client, not "<i>held for the account</i>", given that there is no direct relationship.</p>
Article 4(7)	Removal of porting requirements / limitation to GOSA	<p>We have proposed either removing porting requirements or limiting the requirement for a clearing member to have procedures to facilitate porting to GOSA structures and increasing the flexibility of the requirements, due to the significant legal and practical difficulties with porting.</p> <p>The majority of ETD markets are highly liquid involving relatively standardised products and so it is relatively easy for clients to close out and put back on any relevant positions without the need for a porting mechanism.</p> <p>This should have an equivalent effect to the transfer of the indirect client's positions to an alternative client. Therefore, we think that it should be possible to achieve consistency with Level 1 whilst making the requirements relating to porting less burdensome or removing them altogether.</p> <p>Amelioration or removal of the porting requirements would also avoid the need for a delay before initiating the liquidation of positions, whilst a clearing member triggers relevant porting procedures. This would generally provide better protection for the relevant counterparty, given the extremely remote likelihood of porting being successful in an insolvency situation and the fact that the speed with which positions can be liquidated can contribute to minimising any loss on the liquidation of these positions and collateral.</p>
Article 4(8)	Conforming clearing member's risk monitoring	Both CCPs and clearing members are subject to obligations to "identify, monitor and manage" risks related to indirect clearing arrangements. However, the CCP's obligations are

	obligation with equivalent obligation on CCP	<p>limited to "material" risks that "could affect the resilience of the CCP". We propose that the same wording is included for the clearing member's obligation to ensure (i) consistency and fairness in the requirements on CCPs and clearing members, respectively; and (ii) that clearing members do not face an entirely open-ended obligation that may be impossible to comply with.</p> <p>We also propose that the clearing member's obligations under this provision are by reference to the information received from the client under Article 5(7). This is to address the concern that this obligation could be read as requiring the clearing member to perform due diligence and credit assessments on each indirect client, which would not be practicable or scalable and would likely result in the cessation of indirect clearing services.</p>
Article 5(1)	Deletion so that the requirements of the RTS only apply in respect of the first four parties in a chain	We have amended Article 1 to provide that only the first four parties in any indirect clearing arrangement must comply with the RTS, even if the chain contains more than four parties. For the same reasons, Article 5 should not therefore apply to 'indirect clients' as if they were clients.
Article 5(4) (now Article 5(3))	Equivalent amendment to Article 4(5) regarding number of accounts at the CCP	See amendment to Article 4(5).
Article 5(8)	Deletion of Article 5(8)	<p>We have deleted the requirement on a client to ensure that liquidation proceeds returned to it for the account of an indirect client are protected from the client's insolvency estate.</p> <p>Absent statutory or other local law protections (e.g. under the UK client money regime), this would require clients to put in place bespoke arrangements which will depend on the insolvency laws of the relevant jurisdiction(s) of the entities in the chain. Whilst it may be possible for clients to meet this requirement by on a case by case basis, clients will not generally be able to use a scalable solution to meet this requirement. The requirements in longer chains exacerbate the cost, operational and other consequences of this requirement.</p> <p>In addition, Article 5(8) goes beyond the requirements at Article 48(7) EMIR, and so is not required under Level 1.</p>
Article 5(9) (now Article 5(7))	Clarification regarding client's requirement to provide information to clearing member	The addition of the word "material" is introduced to conform with the proposed amendments to Article 4(8). We have also clarified that the client needs to submit to the clearing member sufficient information to identify the indirect clients only when the indirect clients have selected gross omnibus



		segregation, because only in that scenario will the indirect clients have any realistic chance of receiving a direct payment from the clearing member. We understand that this was the intention of the previous wording (the reference to paragraph 2 is a reference to indirect clients that select gross omnibus accounts).
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## Annex – Responses to Consultation Paper Questions

**Question 1: Do you agree with the proposed approach to require the choice between an omnibus indirect account and a gross omnibus indirect account with margin at the level of the CCP?**

Yes, we agree with the proposed choice between an omnibus indirect account (NOSA) and gross omnibus account (GOSA) with collateral to be held at the CCP (other than additional collateral above the amount called by the CCP, which we agree should be treated in accordance with relevant contractual arrangements).

However, we do not agree that a clearing member should be required to open a separate NOSA and/or GOSA at the CCP for holding the assets and positions of the indirect clients of each client in the indirect clearing chain. Instead, it should be sufficient for each clearing member to open a single NOSA and/or GOSA at the CCP for holding the assets and positions of all of its indirect clients.

Please see Section B of Part I of our response for further details.

**Question 2: Do you agree with the proposed approach for the requirements related to default management? Do you think there are alternative level 2 requirements (compatible with the relevant insolvency regime situations and the level 1 mandate) that would achieve better protections?**

We do not agree with the proposed approach. We have significant concerns with the proposed requirements related to default management. Please see Sections C, D and E of Part I of our response for further detail about our concerns and proposed solutions.

**Question 3: Do you agree that the proposed approach adequately addresses counterparty risk throughout the longer chain by ensuring an appropriate level of protection to indirect clients? If not, are there alternative approaches compatible with Level 1?**

If implemented, the proposals may remove some counterparty risk but would create other risks in the overall clearing structure, including exposing clearing members to increased counterparty risk contrary to the requirements in Level 1 and Recital 1 of the MiFIR RTS. In any event, we do not think the requirements can realistically be implemented as drafted. Please see Section F of Part I of our response, which sets out our concerns with the proposed approach and our proposed alternative approach.

**Question 4: For longer chains, what other details (liquidation trigger and steps, flow and content of information, other) should be taken into account or what additional requirements or clarification should be provided in order to avoid potential difficulties when handling the default of a client or an indirect client facilitating clearing services?**

Please see Section F of Part I of our response, which sets out our concerns with the proposed approach for longer chains and our proposed alternative approach. To the extent our alternative approach is adopted, no further details or requirements should be needed for longer chains.

**Question 5: Do you consider that the new provision assigning by default to the indirect client the choice of an omnibus indirect account following reasonable efforts from the client to receive an instruction is appropriate? If not, what other considerations should be taken into account?**

Yes. As noted in Part I of our response, we welcome this provision.

**Question 6: Do you consider appropriate that the collateral provided on top of the amount of margin the indirect client is called for is treated in accordance with the contractual arrangements?**

Yes. As noted in Part I of our response, we welcome this provision.

**Question 7: In view of the different amendments described above, do you consider that this set of requirements ensures a level of protection with equivalent effect as referred to in Articles 39 and 48 of EMIR for indirect clients?**

Please see Part I of our response, which sets out the key additional amendments that we consider necessary in order to achieve a workable indirect clearing solution and the reasons why we consider these amendments to be consistent with the requirements of Article 30 MiFIR.

**Question 8: Please indicate your answers to the cost-benefit survey.**

Please see Section H of Part I of our response.

**Question 9: Do you have any comments on the draft RTS under EMIR not already covered in the previous questions?**

No. As explained in the introduction to our response, our comments are limited to the draft RTS under MiFIR, which will apply in respect of indirect clearing arrangements for ETD.

**Question 10: Do you have any comments on the draft RTS under MiFIR not already covered in the previous questions?**

Yes, please see the main body of our response.