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(electronic submission to ESMA in the prescribed form)

FIA response to ESMA Consultation Paper

European Securities and Markets Authority ("ESMA") - Consultation Paper on Draft technical advice on commercial terms for providing clearing services under EMIR (FRANDT) (the "Consultation Paper")

FINAL RESPONSE

1. FIA[1] ("FIA") welcomes the opportunity to respond to the Consultation Paper and remains available to discuss this response in more detail.

2. This response is ordered as follows: Introduction; Executive Summary; General Comments; and Specific Comments to the questions raised in the Consultation Paper.

INTRODUCTION

3. FIA and its members appreciate ESMA's intention to develop FRANDT principles in a manner which is consistent with pre-existing industry practices. However, there appears to be a disconnect between ESMA's perception of market practice as indicated in the Consultation Paper and actual market practice. We suggest that more consideration must be given to maintaining the underlying risk management principles that are crucial to supporting safe and orderly clearing markets. As currently proposed, FIA and its members have strong concerns that the implementation of FRANDT could be detrimental to the clearing eco-system and undermine the safety of the financial markets.

4. FIA and its members encourage ESMA to reassess the exact scope and nature of the problem with access to clearing that FRANDT is aiming to address in the context of other recently implemented regulatory initiatives to improve access to clearing. ESMA should be mindful to ensure that any new requirement imposed on clearing firms to implement FRANDT is proportionate to the remaining obstacles to access to clearing and delivers the benefits and policy objectives pursued by EMIR Refit.

5. FIA and its members are concerned that implementation of FRANDT as proposed in the Consultation Paper would in fact lead to a decrease of clearing firms in the market and a barrier to clearing firms seeking to enter the market. This would result in an increase of risk in fewer clearing firms and as a

[1] FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry. FIA's mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. As the principal members of derivatives clearinghouses worldwide, FIA's clearing firm members play a critical role in the reduction of systemic risk in global financial markets.
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result an increase of risk in the clearing system more generally. Ultimately, this would have the unintended consequence of a damaging effect on access to clearing for all derivatives market participants if the availability of clearing services is reduced.

6. FIA and its members therefore strongly urge that ESMA reconsider its approach to implementing FRANDT principles. FIA and its members would like to reiterate that they fully support the policy objective of FRANDT in addressing the clearing access difficulties faced by counterparties with limited OTC derivatives trading activity, and welcome further engagement with ESMA and clients, in order to identify and efficiently resolve the problems clients are facing and that FRANDT seeks to address.

EXECUTIVE SUMMARY

KEY CONCERNS

7. FIA and its members' key concerns with the proposal are client classification, public disclosure of contractual terms and fees and the restrictions on or requirements for some contractual terms, all for the reasons explained in more detail in this response. Highlighting these concerns upfront should not be seen as detracting from the seriousness of other different concerns raised in this response.

8. FIA and its members are strongly of the view that, if not addressed, these key concerns will severely impact clearing firms' ability to properly risk manage their clients with the result that many clearing firms may cease to provide clearing services altogether. A number of unintended consequences follow from this result including more limited access to clearing and increased systemic risk for the clearing industry resulting from a concentration of risk to fewer clearing firms, which is the opposite of what FRANDT is aiming to achieve.

KEY RECOMMENDATIONS

9. Based on the more detailed reasoning set out in the rest of this response, and in addition to recommendations included for each specific question, FIA and its members make the following key recommendations:

(i) *Client Classification* – remove the reliance on client classification from the proposal. A standard system of client classification does not exist and it is not possible to implement in a way that would deliver meaningful benefit for clients.

(ii) *Request for Proposal (RFP)* – FIA and its members would support the production of a standard RFP document that could be used between clients and clearing firms. As noted below, some clients already produce their own RFPs and by tailoring this approach to produce a standard template, comparability across clearing firms may be made easier. It is proposed that a base standard template covering common RFP topics be made publicly available to all prospective clients of clearing firms. By comparing the RFPs received back from clearing firms, clients would then be able to make an informed decision within a standardised framework regarding their clearing firm choice. Such an approach would seem to address FRANDT principles in a more meaningful way without requiring clearing firms to engage in a costly and onerous public disclosure exercise that seems unlikely to improve clients' ability to compare offerings. Clearly, more work is required to develop the detail of this proposal and FIA and its members would be pleased to explore this option further with ESMA, including to provide further detail regarding the types of questions typically submitted by clients when choosing a clearing firm.

(iii) *Contract Terms* – remove all requirements prescribing the manner in which contractual terms are established, modified or communicated. As further explained below, such requirements would have a materially adverse and detrimental impact on clearing firms' risk management efforts and significant ramifications on the clearing system.

(iv) *Determination and Disclosure of Fees* – remove all prescriptive requirements with respect to fees and costs. Costs are proprietary, confidential and commercially sensitive information and should not be subject to further disclosure than is currently required.

(v) *Existing EU legislation* – clarify that FRANDT requirements may be considered satisfied to the extent that clearing firms are complying with other EU regulation that imposes the same or similar requirements.

(vi) *Technology Requirements* – delay prescribing any measures in relation to this element until it has been made clear what specific technology requirements ESMA is seeking to address. Currently, FIA and its members feel unable to provide more detailed recommendations as the problem for clients that FRANDT seeks to address is not understood.

(vii) *Onboarding* – replace the requirement to have a dedicated website explaining the onboarding process with a requirement on clearing firms to make available to clients a generic onboarding process flow upon request and to publicise this availability on their websites. Such an approach would seem to address FRANDT principles of achieving greater transparency without requiring clearing firms to engage in a costly exercise of creating separate, dedicated onboarding websites.

GENERAL COMMENTS

10. FIA and its members have a number of general comments which apply across the proposals in the Consultation Paper. FIA and its members believe these general comments are helpful either to explain further existing industry practices or otherwise to inform further ESMA's approach to FRANDT. The general comments relate to client classification, the role of central clearing counterparties ("CCPs"), the impact of existing EU regulation, the impact of other regulatory initiatives to improve access to clearing and additional policy concerns. These are dealt with in turn.

11. We note that as originally conceived, FRAND principles are a product of EU competition law and were articulated to guide some participants' access terms in areas such as patents and the telecoms markets and not in the provision of a service where substantial amounts of risk could be brought to bear on the financial markets. As noted in paragraphs 13-16, if the proposed FRANDT requirements become unduly prescriptive then clearing firms' abilities to properly risk manage their clients could be severely undermined, which in turn could have significant knock-on effects on the risk equilibrium in the clearing system. FIA and its members cannot stress enough the impact that the FRANDT requirements may have on clearing firms' risk management of clients. Ultimately, these measures may restrict clearing firms' ability to carry out a commercially profitable business, disincentivise the provision of clearing services and create an even higher barrier to entry for new clearing firms entering the market. This would lead to the unintended consequence of FRANDT encouraging less competition in the cleared derivatives markets, potentially less access to clearing for all segments of the market, higher costs for clients and a higher concentration of risk amongst remaining clearing firms.

CLIENT CLASSIFICATION

12. We would like to raise a number of key clarifications in relation to ESMA's proposals:

There is no industry-wide standard that is used for classifying clients:

13. A common theme through the Consultation Paper is the assumption that it is industry practice for clearing firms not only to classify clients, but also to do it in broadly the same manner. By leveraging these assumed classification categories, ESMA's assumption is that clients will be able to compare a number of parameters from fees to contractual terms. Neither assumption is correct. Each client has its unique combination of risk and commercial attributes that require individualised treatment across many aspects of its relationship with the clearing firm. Clients that have the same size, credit quality and operating in similar industries may present very different profiles solely by virtue of their unique trading strategies. The same client's profile could change dramatically due to movement of market conditions or other intervening factors. Even the same client would present different challenges to different clearing firms due to each firm's unique sensitivities such as product exposure, clearing house connectivity, infrastructure limitations, capital structure and other factors. These are among the reasons why there are currently no such industry standard classification criteria.

Further, for standard classification criteria to be useful to clients, all clearing firms' offerings and risk criteria would need to be directly comparable. FIA and its members are of the view that this is not achievable as each clearing firm has its own bespoke internal risk policies and its own specific business structure, products offered, markets served, strategic objectives and resource allocations. Therefore, clients seeking to rely on any standardised classification as a means of comparing clearing firms, are likely to end up confused when they receive different classifications from different clearing firms.

Client classifications are performed to determine client acceptability and for risk management purposes - they are not used to determine fees:

14. The Consultation Paper draws a direct link between a client's classification and the fees it pays. However, this overlooks the fact that typically if client classification is performed at all, it is solely as a risk management tool used to assess whether it is prudent to accept a client and to determine risk terms such as margin requirements. Risk assessment does not drive client fees and fees are not determined according to pre-set client classifications. Fees are commercially agreed on a per client basis, based on a range of factors including anticipated trade volume, products and capital consumption.

Client risk assessments may change over time:

15. FIA and its members are concerned that standardised client classification criteria would seriously interfere with clearing firms' abilities and discretion to risk manage their business effectively and change assessments of clients as warranted by their risk management practices and procedures. The risks of providing clearing services can change over time, and risk criteria weighted more heavily today may be less relevant in the future. Indeed, a clearing firm's assessment of a client's risk profile is based on a number of factors, driven by the market and other conditions out of the client's and the clearing firm's control. Under these circumstances, for the purposes of risk management, the commercial terms, contractual or otherwise, that a clearing firm negotiates with a client must be sensitive to the bespoke and evolving nature of a client's risk profile. Aligning static categorisation with static clearing terms would serve as a conduit for the unintended introduction of increased levels of risk into the clearing system.

Other regulatory obligations in the context of client classification:

16. Providing clients with standardised client classifications may be contrary to a clearing firm's other regulatory obligations. In particular, a clearing firm may alter a client's classification if concerns regarding money laundering or irregular trading arise. In such circumstances, FRANDT principles should not dictate that clearing firms provide reasons for these classification changes, as doing so could result in clearing firms having to choose between complying with FRANDT and their other regulatory obligations.

CCPs

17. There is little exploration in the Consultation Paper of how a CCP may influence a clearing firm's services. In practice, however, a CCP will have a significant impact on some of the areas that ESMA expects to be addressed by FRANDT. For example, the Consultation Paper[2] suggests that clearing firms must make their IT systems more accessible to a wider range of clients. Yet it is frequently CCPs that mandate the IT systems that clearing firms must use. Similarly, the Consultation Paper makes clear that fee disclosure should be subject to FRANDT principles[3]. Yet the fees that clearing firms charge and their ability to disclose these fees are to some extent dictated by the fee structures and policies of the CCPs. The impact of CCPs on the clearing firms' services should be taken into account by ESMA in its development of the FRANDT principles.

IMPACT OF EXISTING EU REGULATION

18. FIA and its members request that ESMA take into account the impact of existing EU regulation and the requirements already imposed on clearing firms and ensure that firms do not effectively become subject to duplicative requirements. For example, some of the proposals in the Consultation Paper overlap with Article 27 of RTS 6[4], which imposes disclosure requirements on EU clearing firms in relation to fees, services and contractual terms. FIA and its members would appreciate ESMA confirming that to the extent a FRANDT proposal is covered by compliance with existing EU regulation, it will be deemed to be complied with.

IMPACT OF OTHER REGULATORY INITIATIVES TO IMPROVE ACCESS TO CLEARING

19. FIA and its members fully support improving access to clearing but are unclear whether any analysis has been undertaken post CRR II[5] and EMIR Refit[6] as to whether there remains an issue. In particular, the impact of the new exemptions from clearing for smaller financial counterparties and the "per asset class" approach to clearing for non-financial counterparties above the clearing threshold introduced under EMIR Refit are not yet known and may achieve the policy driver of making clearing available for those entities subject to the EMIR clearing mandate. FIA and its members would suggest that ESMA undertakes this analysis and focus its efforts in relation to FRANDT on specifically addressing remaining concerns, if any. This should then ensure that clearing firms are not unnecessarily burdened with new requirements without a corresponding benefit for clients and avoid

[2] Paragraph 61 of the Consultation Paper
[3] Paragraph 45 of the Consultation Paper
[4] Commission Delegated Regulation (EU) 2017/589 of 19 July supplementing Directive 2014/65/EU
[5] Regulation (EU) 2019/876
[6] Regulation (EU) 2019/834

the unintended impact noted already of deterring existing clearing firms from continuing to provide clearing services or discouraging new clearing firms from entering the market.

ADDITIONAL POLICY CONCERNS

20. FIA and its members note that there are still fundamental obstacles to access to clearing that FRANDT itself will not solve, for example capital constraints and G-SIB requirements. These constraints are restricting existing firms' ability to expand their businesses and also creating a barrier to entry for potential new entrants. Although this is not an issue that EU regulators can resolve within the context of the FRANDT consultation, FIA and its members urge ESMA to recognise such issues as inherent limitations of FRANDT, so that FRANDT principles are drafted in a way which are proportionate and do not attempt to excessively over-regulate the provision of clearing services to fix a problem which they fundamentally cannot fix (i.e. capital restrictions).

SPECIFIC COMMENTS

21. Turning to address the specific questions raised in the Consultation Paper:

Do you generally agree with the approach on transparency and how to publicly disclose fees and commercial terms and other conditions? Please elaborate and if you disagree with any specific requirement, please suggest alternative ones.

Scope of Services Offered

22. FIA and its members support ESMA's assertion in paragraph 12 of the Consultation Paper that the scope of the FRANDT principles is to OTC derivatives which are covered by the mandatory clearing obligation. The scope of Article 4 of EMIR is explicit in its reference to OTC derivatives subject to the mandatory clearing obligation and FIA and its members therefore understand and agree from the inclusion of FRANDT principles within Article 4(3)(a) that the scope of FRANDT is restricted to OTC derivatives subject to the EMIR clearing mandate.

Publicly Disclosing General Contractual Terms

23. The view of FIA and its members is that this requirement focuses on enhancing clients' understanding of their rights and obligations under their clearing contract, enabling them to better compare different clearing firms' offers. Aside from the material adverse impact stated below, FIA and its members do not agree that requiring clearing firms to disclose standard contracts achieves this goal.

24. By way of background, there are two predominant standard forms of base terms for OTC client clearing that are used by the industry in Europe. These are (a) various forms of Terms of Business as published by the FIA and as may be supplemented by a Clearing Module as published by the FIA or an ISDA/FIA Client Cleared OTC Derivatives Addendum as published by the International Swaps and Derivatives Association, Inc, ("ISDA") and the FIA and (b) a 1992 or 2002 ISDA Master Agreement as published by ISDA and as may be supplemented by an ISDA/FIA Client Cleared OTC Derivatives Addendum. There are also other regional forms available, such as the French law governed Clearing Annex to the Fédération Bancaire Française standard master agreement for derivatives transactions. In addition, many EU clearing firms will have a bespoke/modified version of the industry documentation tailored for their firm's business model.

25. FIA and its members assume that the agreements of the type referred to in Paragraph 24 above are the types of standard contract that are referred to in paragraphs 43 and 44 of the Consultation Paper and would draw ESMA's attention to the following:

(i) Article 27 of RTS 6[7] provides that "a clearing firm shall publish the conditions under which it offers its clearing services. It shall offer those services on reasonable commercial terms." The market has interpreted this as a requirement to publish a high level summary of some of the key terms that they typically have in their clearing documents. This disclosure appears consistent with the aims of FRANDT and some of the proposals in the Consultation Paper. As noted in Paragraph 18, FIA and its members are concerned to ensure that clearing firms do not become subject to duplicative requirements and would appreciate ESMA confirming that to the extent a FRANDT proposal is covered by compliance with existing EU regulation, it will be deemed to be complied with.

(ii) These forms of documents are standard in the sense that they are based on pre-printed standard industry forms but there is a great deal of optionality embedded in them and clearing firms will tailor these documents depending on their business model and requirements and also to ease the negotiation process. In practice each clearing agreement between a clearing firm and its client is individually negotiated such that the final agreement is likely to vary considerably from the pre-printed standard form. It is also often the case that initial terms and conditions offered to a client will significantly change once clearing firms have completed internal risk and credit assessments. FIA and its members are concerned that ESMA has overestimated the value clients will derive from public disclosure of standard contracts and doubt the effectiveness of disclosing general contractual terms as a means of encouraging comparison between clearing firms.

(iii) Many CCPs publish mandatory terms to be incorporated into client clearing agreements where that CCP service is relevant. As a result, some of the terms that ESMA wishes clearing firms to disclose will actually reside on the websites of CCPs. FIA and its members are concerned that requiring clearing firms to make these provisions available would appear unnecessary and duplicative when such terms are already made publically available by the CCPs.

(iv) There are potential copyright issues which may affect the disclosure of such contracts. For example, ISDA and FIA documentation is only available against payment and the licensing terms upon which clearing firms are permitted access to these documents limit their ability to share the documents publicly (such as on a website). Moreover, there are additional copyright and confidentiality considerations for firms that use bespoke wording in their contractual documents. FIA and its members are concerned that public disclosure of these documents would undermine such copyright and confidentiality. In order to avoid such issues, FIA and its members would support copyrighted documentation, such as that listed above, being made available upon request to clients from the relevant copyright holder. This approach would ensure that clients still receive access to the documents in a manner compliant with FRANDT but would not impose a difficult legal position on clearing firms.

Fees Disclosure:

26. FIA and its members refer to the points made in Paragraphs 13 to 16 which are also relevant in this context and in addition would draw ESMA's attention to the following:

[7] Regulation (EU) 2017/589

(i) The Consultation Paper correlates the public disclosure of clearing firms' fees and ensuring "commercial terms are fair".[8] FIA and its members do not agree such a link can be drawn between the two.

(ii) FIA and its members would like clarity that any disclosure of fees would be in relation to baseline fees, disclosing any more detail than this appears to be well beyond the scope of FRANDT[9]. FIA would highlight that clearing firms are already subject to the MiFID II[10] costs and charges rules, which require them to disclose the actual costs to clients. In any event, even disclosure of baseline fees may not portray a fair representation of what a client would actually be charged once volume discounts and other commercial aspects have been taken into account. In practice, the actual prices that a clearing firm will charge to a client will only be known once the clearing firm has considered the client's portfolio, transaction scope and any complexities of the client type/jurisdiction and bespoke requirements/requests of the client. These parameters may evolve through the negotiation process, and may change through the contractual relationship, for example, where trade volumes differ from anticipated volumes, where the client signs up for additional services or where a clearing firm is required to increase fees over time. FIA and its members are concerned that generic disclosures provided by clearing firms without any reference to an individual client's needs are therefore unlikely to provide a useful comparison for clients, and may potentially be misleading.

(iii) It is impracticable for clearing firms to include disclosure on exact fees charged by CCPs. There would be substantial costs for clearing firms to publish that information and having them do so would appear unnecessary given the information is already provided by the CCPs.

(iv) FIA and its members assume that clearing firms would not be required to disclose all the types of fees listed in the Consultation Paper but only those that the clearing firm charges. For example, if a clearing firm does not charge an onboarding fee (explicitly or implicitly), it is assumed that they will not be required to change their fee structure to construct an onboarding fee for the purposes of disclosure. FIA and its members are concerned that if this is not the case then the FRANDT principles would be dictating how clearing firms structure client pricing which would impact their freedom to contract and to set up their own fee structure. Ultimately it may act as a disincentive to the provision of clearing services.

(v) There is an increased prevalence of clients who send an RFP to potential clearing firms. Clients sending out RFPs will provide information about their portfolios and any documentation requirements upfront and in return clearing firms will provide information regarding pricing. The responses to the RFPs enable clients to effectively carry out their own comparisons across different clearing offerings without requiring clearing firms to publicly disclose fees or anything else for that matter.

Recommendations:

27. FIA and its members do not believe that disclosing contractual terms will serve clients in the ways envisaged in the Consultation Paper. However, as noted in Paragraph 25(i), clearing firms already disclose service offering details and a high level summary of client clearing terms in response to other

[8] See paragraph 38 of the Consultation Paper

[9] By publishing an actual range of fees, an educated market observer could make a reasoned guess as to the fees paid by specific entities given general market knowledge about which clients clear with which clearing service providers. It could also enable well educated and informed market participants to make estimates of the likely typical sizes of risk positions being held by those same participants.

[10] Directive 2014/65/EU

EU regulatory requirements, for example, RTS 6 and would support in principle a similar requirement here. Clearing firms would also be open to publicly disclosing the types of documentation and a high level summary of client clearing terms that they offer with respect to client clearing.

28. Clearing firms would also be prepared to disclose many of the terms envisaged by FRANDT principles on a bilateral and confidential basis with prospective clients following a bona-fide enquiry. The clearing firms' websites should be required to provide clear and concise instructions around how such an enquiry should be made. Once an enquiry has been determined to be bona-fide, information would be shared with the prospective client.

29. In the view of FIA and its members, the disclosure of high level fee models, including how CCP fees are passed through to clients, are already disclosed by clearing firms under Article 39 of EMIR. Clearing firms would not be comfortable with further disclosure around this issue due to substantial confidentiality concerns with sharing the details of bilaterally agreed negotiations. Likewise, it is feasible to share details of when account revenue hurdles/minimum fees are applicable. Furthermore, in regard to the presentation of fees, FIA and its members caution against requirements that would force clearing firms to develop complex algorithms to determine the volume of trades over which to split the fixed costs. The nature of OTC derivatives does not lend itself well to such concepts. For example, a EUR200 million interest rate swap with a maturity of 3 months would be considered a small trade, whereas the same size of notional amount but for a maturity of fifty years would be a very large trade. Requiring clearing firms to provide a measure of fees per transaction is unlikely to be informative and may be confusing given the nature of the underlying products.

Do you generally agree with the elements to be taken into consideration in the commercial terms for the provision of clearing services? Please elaborate and if you disagree with any specific requirement, please suggest alternative ones.

Paragraph 59:

30. FIA and its members note paragraph 59 of the Consultation Paper which states that "[a]ll clearing clients should be treated equally according to their categorisation…" and refer to the discussion in Paragraphs 13 to 16 above. In addition, FIA and its members make the comments below.

Technology Requirements:

31. FIA and its members are not aware of any specific technology issues that need addressing and would be interested to hear from ESMA examples of the issues that the Consultation Paper hopes to resolve. In addition, FIA and its members would draw ESMA's attention to the following:

    (i) FIA and its members strongly believe that the technology requirements should not be driven by the least sophisticated market participants and are keen to understand the statement that "[t]here should be possibilities to have less advanced processes for accessing a clearing service provider where a simple service is required". [11] The comparison to CCP requirements[12] is unreasonable in this respect given that there are significant requirements to become a member of a CCP and so CCPs are not required to develop their services with the simplest member in mind.

[11] See paragraph 63 of the Consultation Paper
[12] See paragraph 61 of the Consultation Paper

(ii) Technology solutions are the only means of providing cost efficient services for some clearing firms. FIA and its members are concerned that requiring clearing firms to provide different technology solutions for different clients may impact the commercial viability of providing clearing services.

(iii) Technology requirements imposed on clients are not as complex in practice as is envisaged in the Consultation Paper. Providing a streamlined and focused technology solution to clients is all part of a clearing firm's competitive offering. As a result, it is often clients that make technology demands of clearing firms, for example asking if a certain data feed can be linked to the client's systems. These are not requirements imposed upon the client, so much as requested by the client.

(iv) Technology requirements often derive from the prevailing market view. The use of key market technologies, such as affirmation and execution platforms, are an example of technology requirements imposed upon clients by market forces rather than clearing firms.

Standardised Commercial Terms:

32. FIA and its members refer to the discussion at Paragraphs 13 to 16 and Paragraphs 27 to 28 and in addition would draw ESMA's attention to the following:

(i) There is no standardised means of negotiating with clients. A comment accepted for some clients may not be acceptable to other clients, as negotiations will take into account a myriad of factors such as credit appetite and counterparty risk. To bind clearing firms to a uniform approach to all clients would severely restrict their ability to fully manage risk and their clients' ability to contract freely. This in turn could cast doubt on arms-length negotiations based on bona fide risk assessments.

(ii) Clearing clients are sophisticated market participants and client clearing agreements can be subject to extensive negotiation between the clearing firm and client, driven by clients as much as clearing firms. Almost all terms are negotiable to some extent. Clearing firms are not solely in control of the similarity or otherwise of the arrangements across clients. FIA and its members are concerned that it is therefore misleading to suggest that there are standard commercial terms present in all client clearing agreements and similar contractual terms should apply to all clients.

(iii) FIA and its members note that "the contract should not include local law requirements only as references to the local law but should replicate its content"[13]. Local law references are not included so as to be obtuse or confusing to clients but rather to provide a reference to certain legal provisions that clearing firms have already analysed and clients may wish to take a view on. FIA and its members are concerned that including the full legal text, rather than the industry standard reference to them could (A) be misinterpreted as providing legal advice when in fact references to local law should be for the client to interpret; (B) could make agreements overly complex and confusing for clients as local laws may be many pages long; and (C) raise questions as to whether clearing firms would then also be expected to make clients aware of any local law changes and subsequently amend the contracts which would not be practical to maintain.

[13] See paragraph 65 of the Consultation Paper

(iv) Further to (iii) above, it should also be noted that local laws are often incorporated into agreements by reference to "all Applicable Laws" (or the equivalent). Such drafting is market standard and relates to all laws that may apply to the fact pattern at hand. The application of ESMA's proposals to such drafting would be practically unworkable as not only would it be almost impossible for clearing firms to ensure that all local laws are outlined within the agreement but it would also substantially increase the size of the agreement to the extent that it would be rendered unusable and not helpful for a client. Moreover, bilateral amendment agreements would be necessary each time any relevant law changed, which would place further documentation burdens upon both the clearing firm and the client.

(v) FIA and its members note that "commercial terms should not include unnecessary duplicative terms" and that "The commercial terms documenting the relationship should be clearly drafted, complete and concise and where several documents are part of the provision of the clearing service, a clear structure of the hierarchy of documents should be provided."[14] FIA and its members refer to Paragraph 25 and note further that in practice CCP terms do overlap with those included in client clearing agreements negotiated by the clearing firms, since CCPs do not have sight of all the terms a clearing firm may include in its client documentation. In addition, CCP terms are not usually included in documentation sets sent to clients. Instead, they are just incorporated by reference as amended from time to time.

(vi) FIA and its members would welcome further clarity on what is expected by "where such [contractual] requirements are not derived from EMIR or other regulatory requirements, such terms would need to be objectively justified to be considered commercial terms compliant with the FRANDT principles"[15]. This would appear to require clearing firms to justify every contractual term not derived from EMIR or other regulation on the basis of FRANDT. FIA and its members are strongly concerned about the scope this provides for confusion, as what is commercially reasonable for a clearing firm may not be so for a client and vice versa. In addition, it is once again important to note that parties' freedom to contract should not be infringed by FRANDT. FIA and its members are ultimately concerned that this will also have the unintended impact of stifling the market and disincentivising clearing firms from providing clearing services.

(vii) FIA and its members would welcome further clarity on what is expected by the statement that"[t]he contract terms should avoid any provisions requiring a clearing client (where such clearing client is also acting as a clearing service provider) to disclose any confidential or sensitive business information to the clearing service provider unless required under EMIR or any other applicable regulation and the details of any indirect clearing client should remain anonymised"[16]. Clearing firms' internal policies can require confidential information from clients. Often this is due to regulation; however, this will not always be the case. FIA and its members are concerned that the Consultation Paper suggests that clearing firms will no longer be able to request such information even when part of managing a client's risk profile. This would increase risk in the clearing system and may disincentivise clearing firms' willingness to contract with certain clients.

[14] See paragraph 65 of the Consultation Paper
[15] See paragraph 66 of the Consultation Paper
[16] See paragraph 69 of the Consultation Paper

Changes to Commercial Terms:

33. FIA and its members agree that changes to commercial terms may be disruptive to clients and it is important that such changes are reasonable. However, FIA and its members would draw EMSA's attention to the following:

(i) It is important to separate unilateral changes that form part of a clearing firm's risk management tools and those that are to the detriment of the client. FIA and its members are concerned that the proposals could put clearing firms in a position where complying with their responsibility to act fairly and reasonably may require them to subordinate their commercial interests to those of the client or compromise prudent risk management. In this context, FIA and its members question whether a clearing firm's risk model constitutes 'commercial terms' in the same way as fees, for example. While a risk model can distinguish one clearing firm from another and so can play a role in the decision of a client to contract with one clearing firm over another one, mitigation of risk remains a primary concern for clearing firms. Paragraph 72 of the Consultation Paper contemplates that only changes in applicable law or the rules of the CCP necessitate a more rapid amendment to clearing firms' risk models which could itself contravene prudent risk management. FIA and its members are concerned that restricting clearing firms' ability to more actively manage its risk models by quickly updating affected commercial terms increases risk in the clearing system and may disincentivise clearing firms' willingness to contract.

(ii) There are additional circumstances to the ones listed in the Consultation Paper in which unilateral changes may be necessary. FIA and its members would like clarity from ESMA that the circumstances described in the Consultation Paper are not exhaustive. By providing clearing services, clearing firms act as intermediaries between CCPs and clients, it is therefore important that clearing firms are not exposed to the risk of both of these parties. Unilateral amendments are one means that clearing firms use to mitigate this risk. Indeed, it is important for ESMA to understand that "unilateral amendments" do not mean that the clearing firm can change contractual terms whenever it wishes to do so; rather, this means that a clearing firm can make changes where contracts, which have been negotiated and agreed between clearing firms and clients contain provisions allowing for such changes.

Termination and Replacement:

34. FIA and its members strongly reject the proposal to impose minimum termination periods upon clearing firms and clients and question whether the proposal is compatible with statements in the Level 1 text that clearing firms and clients should "not be obliged to contract"[17]. In addition, FIA and its members would draw ESMA's attention to the following:

(i) It is imperative that clearing firms are able to manage their CCP facing risk and notice periods are a key means of doing so. If a CCP relationship must be terminated due to risk concerns, clearing firms must also have the ability to terminate client clearing agreements where it covers activity of the CCP in question. A six month notice period (or any notice period) detrimentally impacts a firm's ability to reduce risk at the time risk-reducing measures are needed and most effective. As a result, FIA and its members are of the view that the imposition of six-month notice periods is contrary to the principles of sound risk management and will have the adverse effect of requiring clearing firms to introduce broader and more prescriptive termination clauses which may not benefit clients.

[17] See Article 4(3a)

(ii) FIA and its members are unclear on how definitive the proposed six-month period should be or when it would be "reasonable and justified" for a clearing firm to impose a shorter period.[18] For example, paragraph 74 of the Consultation Paper references "the notice periods should be at least 6 months where for example the termination is due to new regulatory requirements…". There is also no recognition of how clearing firms would be expected to comply with the FRANDT principles if they were provided less than six months' notice of regulatory changes. Likewise, clearing firms also need to be able to adapt in a timely manner to changes in regulatory interpretation or rule changes from the CCPs themselves, e.g. due to an ESMA Q&A or CCP rulebook change.

(iii) FIA and its members refer to Paragraph 25 and in this context are further concerned that these proposals may contravene obligations under Article 25 of RTS 6. RTS 6 requires clearing firms to conduct due diligence and monitor clients against certain risk/operational standards and take appropriate action. Appropriate action should include the ability to terminate a client relationship if the client no longer fulfils a clearing firm's required criteria. In addition, while there is a 'reasonable and justified' carve out in the draft technical advice, RTS 6 is distinguishable because it does not state minimum requirements but leaves it to the clearing firm to make the determination under Article 25 of RTS 6.

(iv) FIA and its members acknowledge that the negotiation of contractual terms for clearing between a client and a clearing firm may take time. However, regulatory mandated termination periods would force clearing firms to maintain a committed line of credit guaranteeing client obligations and would dramatically change incentives and behaviour which may lead to risk-taking behaviour on the part of clients. Termination periods must reflect a balance to protect the interests of the clearing firm as well as those of the client. FIA and its members are concerned that the proposal may require clearing firms to continue offering certain product types despite such products being burdensome both from a financial and risk perspective. For example, clearing firms should not be required to maintain clearing services for at least six months even if only one client is using them. Ultimately, again, the proposal may increase risk in the clearing system and disincentivise clearing firms from offering clearing services.

Recommendations:

35. *Technology requirements* – FIA and its members recommend delaying prescribing any measures in relation to this until it has been made clear what specific technology requirements ESMA is seeking to address. Currently, FIA and its members feel unable to provide more detailed recommendations as the problem for clients that FRANDT seeks to address is not understood.

36. *Standardised commercial terms – Termination and replacement* – These types of termination rights are an important part of how firms risk manage their clearing businesses (both with respect to particular clients, as well as risks related to providing clearing services on a particular CCP). In any particular client negotiation, clients may ask to adjust up or down the length of these termination periods depending on other commercial terms prioritised by the client – for example, a client may want to negotiate more favourable margin requirements, and in exchange agree a shorter "no fault" termination period. Instead of imposing fixed termination periods clearing firms should be required to ensure any no fault termination periods are reasonable in light of the risks involved and the other commercial terms with that client.

[18] Article 4(3)of draft technical advice attached to the Consultation Paper

Do you generally agree with the suggestions to assist in facilitating access to clearing services? Do you generally agree with the requirements listed to ensure prices are fair, proportionate and non-discriminatory? Please elaborate and if you disagree with any specific requirement, please suggest alternative ones.

Onboarding Process:

37. FIA and its members are of the view that clients, as sophisticated market participants, are unlikely to require a dedicated website explaining the onboarding process. Instead they might see this as an additional resource for which costs may be passed on to them. Indeed, we are unaware of any other related services for which a dedicated website is required. Consequently, this requirement should be removed and replaced with a requirement to include, on each clearing firm's pre-existing website, access to an onboarding process flow. Further details relating to this process flow are outlined in the recommendations section below.

38. FIA and its members note the requirement to disclose estimated timelines and would draw ESMA's attention to the following:

    (i) FIA and its members are concerned that this could lead clearing firms to try to compete on estimated timelines (race to the bottom) and incentivise firms to publish overly ambitious/unrealistic timelines to make them appear more appealing to potential clients. Indeed, where a firm actually does aggressively reduce its timelines for onboarding, this creates the risk of cutting corners on carrying out proper due diligence checks, which would be highly undesirable from a regulatory perspective.

    (ii) Estimated timelines could be misleading for clients since the actual timelines are highly dependent on individual clients' level of engagement and not just action by the clearing firm.

    (iii) The type of onboarding may impact the timeline: client type (new client relationship versus an additional account), account type (some products are easier and quicker to on-board than others), client location and type of fund (drives the KYC / due diligence requirements).

Proportionate prices and fees:

39. FIA and its members strongly disagree with the proposal set out in paragraph 85 of the Consultation Paper requiring clearing firms to disclose the costs assumed by a clearing firm in providing clearing services. This information should not be publicly disclosed as it is commercially sensitive and would be contrary to the Level 1 text which states that FRANDT should not amount to price regulation. As already mentioned in Paragraph 26(ii), clearing firms are already subject to the MiFID II costs and charges rules, which require them to disclose the actual costs to clients. It is questionable whether clients currently use these disclosures and there are proposals under the MiFID II review to re-evaluate these rules given that sophisticated clients generally do not find them beneficial.

40. In addition, FIA and its members refer to the discussion at Paragraph 26.

Recommendations:

41. *Onboarding Process* – Clearing firms could be obliged to provide an onboarding process flow document upon request from clients. This document would outline the general onboarding process, documentation involved and indicate that further information can be obtained via the RFP proposed in Paragraph 9(ii). FIA and its members would like to draw ESMA's attention to the fact that the

timelines are in large part dependent upon the level of interaction from the client and so may be subject to change on that basis if, for example, key individuals within the client firm are unavailable for prolonged periods. This schedule would therefore contain the key information required by the Consultation Paper but would do so in way that is not detrimental to the confidentiality requirements of the clearing firms.

42. Further to Paragraph 9(ii), FIA and its members believe that the inclusion of a specific onboarding section in an RFP document would go a long way to achieving ESMA's FRANDT aims. This would allow clearing firms to provide additional information to clients, such as indicative timelines, once they have a better understanding of the clients' unique requirements and risk profile. In addition, this section could also be amended by clients such that it better represents the specific queries they have regarding onboarding.

43. FIA and its members would like to emphasise that the above is simply a suggestion of how this problem is to be addressed. More detail on the substance contained within the onboarding process flow is required, and FIA would be happy to discuss with ESMA a solution which best complies with FRANDT.

44. *Proportionate prices and fees* – Fees could be based on:

(i) Minimum fees (costs of clearing, such as CCP onboarding costs, clearing rate fixed etc.);

(ii) transactions / volumes cleared (further discounts if higher volume cleared due to cost efficiencies);

(iii) margin types

(iv) client risk

(v) netting vs non-netting jurisdictions.

45. Nonetheless, fees are difficult to quantify in the abstract, and there is a concern that any such disclosures could be misleading to clients. To address the need for transparency, we would suggest requiring firms to ensure that all fees charged to clients are clearly set out on client statements (rather than the requirement to disclose publicly).

Do you generally agree with the proposed elements regarding the risk control criteria? Please elaborate and if you disagree with any specific requirement, please suggest alternative ones.

Risk Elements:

46. FIA and its members would ask ESMA to note the following:

(i) Clearing firms are already subject to client risk assessment requirements in RTS 6 and clearing firms must also meet local regulatory requirements around conduct of business. FIA and its members refer ESMA to the discussion at Paragraph 25 in this regard.

(ii) The process of risk-assessing clients proposed by the Consultation Paper goes well beyond what should be considered appropriate in terms of risk management. Most clearing firms already disclose the risk factors that are assessed (in line with current requirements under MIFIR) and any additional requirements with regard to justification and explanations of how

the factors determine assessment are considered proprietary information of each clearing firm.

(iii) The Consultation Paper suggests credit risk aspects of clearing firms' relationships are determined by client categories. The issues arising from client classification are discussed at Paragraphs 13 to 16. In this context, FIA and its members note that clients within the same categories can present substantially different credit profiles. Thus clearing firms need to maintain the right to implement different risk controls (or implement the same controls differently) on clients within the same client categories.

(iv) In addition to concerns surrounding the disclosure of proprietary information, FIA and its members believe it would be impractical to publish standardised risk control criteria as the risk criteria (relating to margin, market access, exposure appetite, etc.) that drive a client's credit assessment are too extensive and dynamic to standardise or codify effectively.

(v) FIA and its members would ask that ESMA refine the scope of the non-discriminatory aspect of the new requirements to exclude credit risk controls. Without such refinement, there seems to be a conflict between FRANDT, which seeks to ensure clearing firms act in a non-discriminatory manner, with prudent credit risk management where the purpose is to discriminate between the credit qualities of clients.

Client Clearing Classification:

47. Please see discussion at Paragraphs 13 to 16.

Recommendations:

48. *Risk elements* – any risk control criteria set out in the delegated regulation should be suggestions, rather than mandated factors. As discussed, risk factors are clearing firm dependent and a prescriptive list could be too onerous for some clearing firms but not detailed enough for others.

Do you identify other benefits and costs not mentioned above associated to the proposed approach? If you advocated for a different approach, how would it impact this section on the impact assessment? Please provide details.

49. ESMA's cost benefit analysis does not accurately reflect the costs for clearing firms. ESMA indicate that their approach ("Policy Two") is simply codifying existing practice and so costs for clearing firms should be similar or only slightly higher than at present. FIA and its members strongly disagree that this is the case as evidenced by the points made in this response to the Consultation Paper and believe that if adopted as proposed, the FRANDT requirement would amount to a substantial change from today's market practice requiring more repapering and new infrastructure build. These additional requirements on clearing firms would have limited benefits to clients and could lead to fewer firms providing clearing services.

We look forward to continued engagement on these important issues.

Yours sincerely