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FIA response to EMIR 3.0 proposal and prudential requirements amendments

I. Introduction & Executive Summary

FIA[1] supports open, transparent and competitive markets. We seek to protect and enhance the integrity of the financial system, and promote high standards of professional conduct. FIA represents a wide array of market participants from around the world that depend on these markets including exchanges, clearinghouses, executing brokers, clearing members, software vendors, specialized legal firms, proprietary trading firms and commodity specialists.

We welcome the opportunity to provide feedback and embrace many of the proposed amendments included in the European Commission's ("Commission") European Market Infrastructure Regulation ("EMIR 3.0") proposals seeking to enhance further the competitiveness, efficiency, and resiliency of financial market infrastructure in the European Union ("EU"). FIA supports many elements contained in the proposal, including the **simplification of procedures for central clearing counterparties ("CCPs") to launch products and change models** through the non-objection and ex-post procedures for granting a request for extension of activities or services (Article 17a and Article 49) , the application of **participation requirements for non-financial counterparties** (NFCs), the proposed **changes to collateral requirements**, the **removal of the need to have an equivalence decision** as a prerequisite to benefit from the intragroup transaction exemption, and the **clearing obligation exemption** for contracts between EU counterparties and public scheme arrangements established in a third country. These proposed changes will improve the competitiveness and attractiveness of EU clearing. In addition, we **support the introduction and the possibility for the Commission to follow a more proportionate approach for the recognition of a third-country CCP**.

Whilst FIA recognizes the ongoing efforts by the Commission to improve the attractiveness of EU CCPs, the EMIR 3.0 package contains **proposals that may ultimately negatively impact the competitiveness of EU firms** and also harm the efficiency and resiliency of the clearing ecosystem. Most significantly, FIA is concerned with the proposed **Pillar 2 prudential measures and the Commission's active account proposal**, which could have detrimental impacts for EU market participants and create competitive disadvantages for EU banks and clearing members. These proposals will not only result in commercial, financial, operational and risk management implications and create additional barriers to providing services to clients (which non-EU banks do not have), **they will also strongly impact EU investors and pension funds**. Furthermore, there is a **lack of a proper impact assessment** not only for the set-up of active accounts but also for the need to maintain two different accounts on UK and EU CCPs.

FIA remains convinced that mandatory EU active accounts would be detrimental to risk management, operational efficiency and broader EU competitiveness. In particular, FIA disagrees with the proposal to

[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. Our membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 countries as well as technology vendors, law firms and other professional service providers. Our mission: To support open, transparent, and competitive markets, protect and enhance the integrity of the financial system, and promote high standards of professional conduct.

introduce quantitative thresholds as part of the active account requirement. Should the decision to set quantitative thresholds be taken, it is of utmost importance to **ensure that any clearing levels and phase-in timelines chosen would not disadvantage EU firms** vis a vis their international peers. Moreover, the active account proposal should be adapted to protect EU firms' competitiveness, for instance, to include in the scope only the activities where the choice of where to clear belongs to the EU market participants which are subject to the EU clearing requirements. Market making and client-clearing activities are only "client driven" activities (ultimately, only clients are choosing where to clear a transaction and in which CCP). Both of these core activities with non-EU clients or EU clients not subject to EMIR ensure EU firms remain competitive and also ensure hedging and re-hedging is performed in an efficient manner, which is at the core of market making and clearing activity globally.

CCPs in the EU are already highly developed, sophisticated market infrastructures subject to clear and comprehensive regulatory requirements thanks to robust regulatory frameworks like EMIR that include appropriate governance structures, operational resilience requirements and anti-procyclicality measures, among other measures. It is worth noting that EU CCPs in certain asset classes are class leaders today, and have grown a proportion of clearing activity in the EU in other assets classes like exchange traded futures and options, interest rate swaps and CDS markets.

FIA supports the application of participation requirements for non-financial counterparties (NFCs) to ensure margin requirements and default fund contributions are met, including in stressed market conditions (Article 37). Moreover, we support the proposed changes to collateral requirements that allow CCPs to accept public guarantees or public bank or commercial bank guarantees as collateral (Article 46).

It is also worth emphasizing that the current energy crisis has shown that the market needs strong clearing members and more capacity, and any regulatory measures should further enable a healthy clearing ecosystem. We strongly advocate for all requirements to be designed in a manner that makes clearing more attractive, and to facilitate further the offering of clearing services to the marketplace.

We also see benefits stemming from the clearing obligation exemption for contracts between financial or non-financial counterparties and public scheme arrangements established in a third country and exempted from the clearing obligation under its national law (Article 4), as well as the clearing obligation for financial counterparties to include, when calculating their aggregate month-end average positions, all OTC derivative contracts that are not cleared in a CCP authorized under Article 14 or recognized under Article 25 (Article 4a).

We also want to remind that **regulatory and supervisory co-operation is a critical component of any cross-border market**, as interest rates swaps, CDS, metals, energy, etc. are traded in what are global derivatives markets. The proposed regulatory fragmentation is counter to safe and efficient markets, the attractiveness of EU capital markets, and global consistency and alignment. Therefore, a globally consistent approach remains important to deal with any emerging issues.

Finally, FIA recommends the addition of a carve-out for the use of **Post-Trade Risk Reduction (PTRR)** techniques (their non-price forming transactions) as this would support the Commission's goal to strengthen the competitiveness of clearing and the derivatives markets in the European Union.

Therefore, whilst FIA recognizes the ongoing efforts by the Commission to improve the attractiveness of EU CCPs, we have the following more detailed concerns and clarification requests on some of the provisions included in the EMIR 3.0 legislative proposal and on the amendments to the prudential requirements under CRD and IFD:

II. Prudential requirements (amendments to CRD/IFD)

FIA has the following concerns regarding the proposed amendments to the Capital Requirement Directive (CRD), and the Investment Firms Directive (IFD):

- The thresholds for 'proportion' and 'concentration risk' will vary given that both are aimed at different outcomes (risk management for specific firm vs financial stability concerns of EU Member States).

- There is a lack of clarity as to what happens if the active accounts proposal results in a breach of concentration risk levels for EU CCPs.

- Pillar 2 measures are not a suitable tool to 'enforce' the proposed active account requirement and FIA **recommends removing the proposed amendments**. If implemented, the measure will create a detrimental impact for EU banks and competitive disadvantages as it creates an additional barrier to providing services to clients, which non-EU banks do not have. This means that EU banks will have their ability to provide services to non-EU clients curtailed unless client-driven business (market-making and client clearing) with non-EU clients and EU clients not subject to EMIR are naturally and explicitly excluded from the scope of activities.

III. Active account at an EU CCP (Article 7a EMIR)

FIA remains convinced that mandatory EU active accounts, especially if not properly calibrated, would not be beneficial for risk management and cost effectiveness. The split of books and loss of netting benefits resulting from maintaining an additional active account with an EU CCP, and the potential loss in efficiency, can generate additional costs for a proportion of market participants in the medium and long-term. Within the context of proportionality, the Commission together with ESMA and the co-legislators should review this policy's impact and appropriateness through a **detailed cost-benefit analysis (CBA).**

There is a lack of proper impact assessment not only for the set-up of active accounts but also for the need to maintain two different accounts at UK and EU CCPs. More specifically, within the context of proportionality, the active accounts review and impact assessment should be launched to ensure an appropriate understanding of: (1) the impact this would have on the capacity of the Clearing Service Providers (CSPs) in order to onboard the number of accounts required, especially in light of the expected timeframes and; (2) the resources required for CSPs to maintain these accounts and their associated use of risk capacity as well as ongoing regular due diligence, etc, and (3) the impacts more generally on the attractiveness of EU markets.

We further note that the **impact** of the active account requirements **will be felt most strongly by EU investors and pension funds**.

Furthermore, FIA disagrees with the current proposal's rule to mandate EU active accounts with a minimum quantitative clearing threshold[2]. Rigid quantitative thresholds, especially if not properly calibrated, could

[2] https://www.fia.org/articles/fia-isda-aima-and-efama-publish-statement-ecs-proposed-amendments-emir

make the execution and management of each and every trade extremely complex thereby negatively affecting market transparency /price discovery and, consequentially, liquidity. They could also negatively impact decision-making in very dynamic markets and the ability of EU firms to meet house and client demands.

We would also like to highlight that the supervision of any quantitative thresholds would be difficult in light of the number of firms subject to the active account requirement. We further note that quantitative thresholds requirements are problematic for products where there is not sufficient liquidity at EU CCPs.

<u>Further to the above concerns by FIA members with the active account requirement, FIA members have identified the specific technical and practical difficulties with the Commission's active account proposal.</u> <u>**The active account proposals as currently proposed are unworkable for the following reasons**:</u>

- The proposal creates continued uncertainty by delegating significant tasks to ESMA for calibrating the active account requirements without providing sufficient direction in terms of protective measures for the competitiveness of EU market participants at Level 1. **FIA recommends ensuring that any measure chosen would not disadvantage EU firms vis a vis their international peers.**

- Active account requirements will be applicable upon entry into force of the Level 1 regulation while EU market participant lack information on the definition of an active account.

- It is clients who decide where contracts are cleared. Therefore, a market maker or clearing member or client that provides clearing services cannot be considered subject to a requirement which requires them to clear a certain proportion of trades on a specific CCP.

- For client clearing, the clearing member is also not the beneficial owner of the position.

- EU clearing members or clients that provide clearing services and market makers may have to offboard and/or restrict business with non-EU clients which are not subject to EU clearing requirements. Both of these core activities enable EU firms not only to remain competitive but also to ensure efficient hedging and re-hedging activity, which is at the core of market makers' activity at a global level.

- It would have a considerable negative impact on the international competitiveness of EU banks as non-EEA clients and EEA clients not subject to EMIR would not be subject to the active account requirements.

- A client might have different clearing members or clearing service providers for different CCPs; hence one clearing member or client that provides clearing services only clears a part of the client's transactions. clearing members who clear derivative contracts in the product categories affected by the Commission's proposal outside of the EU may be disproportionately affected. These trades would count in the reporting requirements and may lead affected clearing members to reduce or stop clearing activities for some clients.

- EU clearing members would no longer fulfil the requirements to remain a clearing member at the third country CCP (TC-CCP) if they cannot take part in default auctions. In addition to that, EU default auctions without having access to the full and available liquidity pools could weaken the robustness of EU financial stability.

- At present it seems as though the requirement to open an active account comes into force as soon as the text is published in the official journal (OJ). Given that it typically takes around 9 to 12 months to onboard to a CCP, this implies EU entities will have to assume the more detailed and actual active account requirements and the content of Regulation up to a year ahead of its publication and commit to contracts which may prove, ultimately, to be unnecessary. As such, recital 11 should not set a date by which the reduction of exposure should be effective.

Furthermore, FIA welcomes clarification in some areas of the proposal in regard to the active account requirement (Article 7a) **which remain unclear**:

- The proposal establishes that FCs and NFCs+ under a clearing obligation shall clear at least a proportion also of Short Term Interest Rate Derivatives (STIRs) denominated in euro with an EU-CCP and it is not clear from the current text that this relates to just economically equivalent contracts even if traded at another venue and cleared by an EU-CCP.

- The proposal still does not provide any clear guidance as to why current exposure to UK CCPs is considered excessive and what risks the proposal is aiming to address.

- There is no Level 1 guidance to determine where the ‘proportion’ levels are to ensure the relevant instruments are not of substantial systemic importance anymore. This could potentially be significant and the lack of guidance is not helpful. (e.g. ESMA report redacted).

- There is no explanation why the requirement does not extend to Tier 1 CCPs (across all jurisdictions) recognized under Art. 25 EMIR.

IV. Transparency (Article 38)

FIA supports increased transparency on margin models but believes the **margin models’ information should be provided by the CCPs** as CCPs are the owners of these margin models and are best placed to provide all the necessary transparency and relevant information to any participants. **Such critical and important information should not be requested from clearing members** but rather made available at all times by the CCPs. It must be noted that clearing members do not have adequate insight into the CCPs models for either base or core margin and have limited (to no) information on add-on models (such as stress or concentration margin add-ons). Such a clearing member requirement is not feasible practically (e.g. technology/IP) and it is not a sensible operating model to place clearing members as the middleman. This is made even more complicated by the fact CCPs are shifting to VaR based margin models. It is important to note that clearing members can and do provide transparency into their own margin call if an add-on to the CCP requirement has been included.

Therefore, it is recommended to amend EMIR Article 38(7) to use generically the term 'margin' instead of 'initial margin' which defines all margins required by CCPs, including initial margin and additional margin. The implementation of this rule would substantially benefit clearing members and their clients to meet the objectives of this transparency policy. EMIR Article 38(7) would read: "*A CCP shall provide its clearing members with information on the ~~initial~~ margin models it uses. That information shall: (a) clearly explain the design of ~~the initial~~ all margin models and how ~~it~~ they operate~~s~~; (b) clearly describe the key assumptions and limitations of the ~~initial~~ margin models and the circumstances under which those assumptions are no longer valid* (…)".

The proposed measures do not take into account bilateral agreements between the clearing member and its client which cover the margin requirement held by the clearing member from the client. This business relationship and the relevant associated documentation already provide the clients with a high level of transparency. Any additional rules should be designed to promote clearing and increase its attractiveness. Additional burdens on clearing members are likely to increase barriers of entry in offering clearing services to the market, especially when setting appropriate margins for their clients. Generally, clearing members should not be restricted in the way they manage risks in relation to their clients based on models approved by their supervisor. A clearing member should always have the right to impose additional buffers themselves, as clearing members absorb the liquidity and credit risk of the individual client.

Moreover, under this proposal, the information to be provided to clients exceeds the level of information that CCPs have to provide to clearing members under current EMIR Article 38(6) and (7)(a)-(c). FIA is concerned that this introduces an additional requirement on clearing members which is difficult, if not impossible, to meet based on the lack of transparency of CCPs themselves. We recommend the information should be provided consistently by the CCPs to avoid clients receiving diverging information from different clearing members or clients that provide clearing services. However, note that clearing members can pass on the information provided by the CCPs to their clients.

Additionally, FIA believes CCPs' transparency can be further improved to achieve such policy objective. As noted in its October 2020 paper on margin procyclicality[3], FIA urged "global standard-setters to continue to enhance transparency into margin models via more precise and/or expanded disclosure standards" to mitigate the impact of unanticipated procyclical margin calls. In FIA's 2015 CCP Risk Position Paper[4], FIA developed recommendations to improve the assessment and management of CCP risk including recommendations to (i) enhance market participants' ability to assess CCP risk through consistent and transparent CCP disclosures; and (ii) ensure initial margin requirements are effective, transparent and predictable to all participants.

The margin calculators made available by CCPs and clearing brokers are just a "what-if-analysis tool" that provides a very good estimate in case of new incoming trades to be cleared, noting also that only one fifth of CCPs provide the tool. However, the issue related to intraday calls is mainly due to market movements leading to losses, regardless of the registration of new trades, and this feature is currently not captured by margin calculators based on previous EOD price. A CCP has available GUIs and reports allowing to check in

[3] *FIA White paper; 'Revisiting Procyclicality: The Impact of the COVID Crisis on CCP Margin Requirements'. October 2020. Available here: https://www.fia.org/resources/fia-issues-white-paper-impact-pandemic-volatility-ccp-margin-requirements*
[4] *www.fia.org/sites/default/files/2020-03/CCP%20Risk%20Position%20Paper%20%28April%202015%29.pdf*

real-time the level of collateral consumption, Initial Margin (IM) and Variation Margin (VM) for each account and this should be made available to clearing members and clients.

BIS CPMI IOSCO also flagged in its report that further work is needed with regard to margin transparency. The report says specifically that 'increased transparency of CCP IM models, which could include forward-looking (predictive) and backward-looking (performance) disclosures – as well as more sophisticated tools/simulators – should enable clearing members and clients to understand ex ante how individual models respond to various market scenarios and to better plan for stressed liquidity needs through increased predictability.

V. Margin requirements (Article 41)

FIA welcomes the proposal for CCPs to continuously revise the level of their margins as opposed to regularly monitor as per the change in EMIR Article 41(1). However, FIA would support additional language to ensure CCPs have models that adequately calibrate margins with procyclicality considerations built-in to avoid any large sudden increase, as observed in the last few years (COVID Crisis and recent Energy Crisis).

FIA recommends clarifying the proposal that a "CCP shall strive to the best of its ability not to hold intraday Variation Margin calls after all payments due have been received". It is unclear what 'after all payments due have been received' means in practical terms. It is worth noting that such provision may be restrictive since payments due might be in a currency different from the one(s) allowed to cover intraday calls. Hence, coverage only in the currency due might cause liquidity issues, especially late in the day.

VI. Intragroup transactions (Article 3)

FIA supports the removal of the need to have an equivalence decision as a prerequisite to benefit from the intragroup transaction exemption. However, we deem the additional empowerment given to the Commission to adopt delegated acts to identify third countries and supplement the list, pursuant to paragraph 4, to be too broad. In the current proposal, a third country can be identified by the Commission if it deems there is a 'risk' (including counterparty risk and legal risk).

VII. CCP Membership Requirements (Article 26)

FIA welcomes the clarification that a CCP cannot be a clearing member, or provide client clearing services, at another CCP. We are supportive of the CCPs maintaining appropriate and well-governed membership criteria.

While we understand that it is not the intent to restrict the ability of CCPs to support interoperability in equity markets, we are supportive of including additional clarification in Articles 26 and 37 and/or recitals that confirms the intention is not to affect interoperability in equity markets.

VIII. Participation requirements for NFCs (Article 37)

FIA acknowledges the rationale behind establishing additional criteria to be met by a non-financial firm if it wants to become a clearing member. These criteria should be risk based, non-discriminatory, transparent and objective to reflect the risk mutualisation at a CCP and ensure access to clearing. The proposal also specifies NFCs should not be permitted to offer client clearing services and only be allowed to keep accounts at the CCP for assets and positions held for their own account. As mentioned in the FIA 'Central Clearing: Recommendations for CCP Risk Management' (November 2018)[5], CCP membership criteria should not be solely based on financial considerations but also consider an objective assessment of specific capabilities (e.g. risk management, operational capability to monitor and control position, ability to participate in default management, if required, and have independent functions). Thus, we welcome the proposal that any criteria 'shall be non-discriminatory, transparent and objective so as to ensure fair and open access to the CCP' and criteria that restrict access shall be permitted only to the extent that their objective is to ensure adequate risk management of such firms by the CCP.

We would note that any further limitations on clearing membership would need to be considered carefully as they may potentially increase member concentration. FIA notes that there is a **capacity limit** as a result of the recent energy crisis, increasing pressure on clearing member intermediaries to take on more business or exposure from energy firms. These energy firms must be able to participate in these markets, and being a clearing member is an efficient way to manage their risk as long as the CCP membership criteria mentioned above are met.

IX. Liquidity risk controls (Article 44)

FIA welcomes the amended second subparagraph in Article 44(1) to better reflect the entities whose default could materially affect a CCPs potential liquidity needs, requiring a CCP to take into account the liquidity risk generated by the default of at least two entities, including clearing members and liquidity service providers.

X. Collateral requirements (Article 46)

FIA supports the amendments to Article 46 to allow bank guarantees and public guarantees to be considered eligible as highly liquid collateral provided that they are unconditionally available upon request within the liquidation period and making sure a CCP takes them into account when calculating its overall exposure to the bank. Furthermore, we welcome the guidance provided for CCPs to take into account any potential procyclical effects when revising the level of the haircuts it applies to the assets it accepts as collateral.

XI. CCP model changes (Article 49)

FIA supports the simplification of procedures for CCPs to change models in Article 49, introducing the requirement to submit an application for authorisation of a CCP model change in an electronic format via a central database, and be subject to a non-objection procedure. Moreover, we support the focus on improving the communication channel between the regulators and the CCP to ensure the application process is pursued in a timely manner.

However, there is concern that the non-objection application process which allows CCPs to implement a non-significant model change before an official notification might create additional risks. Indeed, within 10 working days of the CCP application (and use of the model change), the CCP could be informed that the non-objection has been denied. Within 5 working days of such notification, the CCP should no longer use

[5] https://www.fia.org/sites/default/files/2020-03/Central%20Clearing%20Recommendations%20for%20CCP%20Risk%20Management%20%28November%202018%29.pdf

that model change (Article 49.1b). This could leave a CCP free to use a model change for a maximum of 15 consecutive working days without proper supervisory assessment. We understand in some cases that flexibility is required but this should not be to the detriment of appropriate supervisory governance.

In addition, EMIR Article 28(3) mentions "*The risk committee shall advise the board on any arrangements that may impact the risk management of the CCP, such as a significant change in its risk model,* (…)" and would recommend reminding of such arrangements in EMIR Article 49(1a) prior to CCP submitting their application. EMIR Article 49(1a) would read: "*Where a CCP intends to adopt any significant change to the models and parameters referred to in paragraph 1* ***and in accordance with the CCP's Risk Committee mandate referred in EMIR Article 28(3)****, it shall submit an application for authorisation of such change in an electronic format via the central database referred to in Article 17(7) where it shall be immediately shared with the CCP's competent authority*".

XIII. Post Trade Risk Reduction non-price forming transactions

A carve-out for PTRR (their non-price forming transactions) would support the Commission's goal to strengthen the competitiveness of clearing and the derivatives markets in the European Union[6].

[6] See FIA's response to the EC's review of the central clearing framework in the EU, pages 24, https://www.fia.org/sites/default/files/2022-03/FIA%20_response_EC_Central-clearing-review_FINAL.pdf