European Securities and Markets Authority

The Chair

Date: 27 January 2017
ESMA70-708036281-19

Olivier Guersent
Director-General
DG Financial Stability, Financial Services and Capital Markets Union
European Commission
Rue de la Loi / Wetstraat 200
B - 1049 Brussels

Ref: EMIR Review and ESMA sanctioning powers under EMIR and CRAR

Dear Mr Guersent,

On 13 August 2015, ESMA submitted to the European Commission four reports for the purpose of Article 85(1) of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July on OTC derivatives, central counterparties and trade repositories (EMIR) (2015/ESMA/1251 to 1254).

The primary scope of this letter is to advise the Commission to consider some elements in the context of the current EMIR review, in particular those related to ESMA's supervisory and sanctioning powers under EMIR. We would like to also use this opportunity to emphasise some similar aspects related to CRAs, which would benefit from a joint analysis.

We appreciate the acknowledgement of the suggestions from ESMA's four reports in the EMIR review report published by the European Commission on 23 November 2016. Nonetheless, we would like to provide in this letter some comments on the Commission's EMIR review report, based on the recommendations we included in our four reports in 2015. A summary of the main aspects included in those reports follows in section A of this letter, while a more detailed version can be found in the Annex.

In relation to the credit rating industry in the EU, on 2 October 2015, ESMA submitted to the Commission two sets of Technical Advice and a Report on the regulation of credit rating agencies (CRA Regulation 1060/2009). These papers provided an overview on the functioning of the credit rating industry and the impact of specific provisions of the CRA Regulation. A summary of the main aspects follows in section B of this letter.

Section A: EMIR review

Starting with trade reporting, in Section 9 of the EMIR Review Report No. 4 (2015/ESMA/1254), ESMA provided an analysis of the various requirements related to trade repositories (TRs) that would benefit from some changes and we suggested some specific amendments to achieve those changes. In the Commission's EMIR review report, we appreciate the acknowledgement of ESMA's suggestion that fines for trade repositories need to be increased in order to ensure effective supervision.

However, given the high-level nature of the report, it is unclear to us whether these suggestions will be taken into account and to what extent. In this respect, we stand ready to provide you all the evidence needed to support the incorporation of our suggestions for higher fines into your future legislative proposal.

In particular, ESMA identifies the following specific aspects as essential to ensure that ESMA is seen as a credible supervisor and is able to perform its supervisory responsibilities under EMIR and SFTR:

a) strengthening of ESMA's sanctioning powers and the level of TR fines, which are detailed in Section 1 of the Annex to this letter;
b) enhancement of ESMA's available supervisory tools towards TRs, which are detailed in Section 2 of the Annex to this letter;
c) inclusion of some essential additional requirements for TRs related to data quality and data access, which are detailed in Section 3 of the Annex to this letter; and
d) further specification of certain reporting requirements, which are detailed in Section 4 of the Annex to this letter.

Furthermore, ESMA would like to draw your attention to the fact that Article 5(2) of Regulation 2015/2365 of the European Parliament and of the Council of 25 November on transparency of securities financing transactions and of reuse (SFTR), requires the TRs to "apply procedures to verify the completeness and correctness of the detail reported to it under Article 4(1)" of SFTR. However, given that the sanctions under SFTR are construed as references to EMIR, there is no specific infringement related to a lack of compliance with this provision as it does not exist under EMIR. ESMA would suggest including a similar provision and related infringement under EMIR, in order to properly supervise TRs under both EMIR and SFTR.

Moving from trade reporting and TRs to the other obligations under EMIR, a series of suggestions were made in our four EMIR Review Reports that ESMA believe are important to consider in the context of the EMIR Review and any related legislative proposal. In particular, ESMA identified the following aspects as essential to ensure that the regulatory framework is improved:

a) considering amendments to the clearing obligation framework and reviewing the language of the Articles setting the default management requirements and protections;
b) redefining, simplifying and recalibrating the categories of large and small non-financial counterparties and the related sets of obligations each of these two categories are subject to;
c) improving transparency and predictability of margin requirements, but considering that other proposals, such as the potential macro prudential use of margins and haircuts, are premature; and
d) reconsidering the third country CCP recognition framework in order to ensure a timely and risk based process, that the right set of safeguards are in place, and that ESMA's costs can be adequately covered.

Section B: CRAR topics

In Section 5.2.2 of the Technical Advice on competition, choice and conflict of interest in the credit rating industry (ESMA/2015/1472), ESMA provided an analysis regarding ESMA´s enforcement powers and those areas where we believe there is scope to refine the sanctioning powers in order to increase CRAs' accountability and ensure a more effective, proportionate and dissuasive sanctioning regime. This could be achieved if all requirements of the CRA Regulation had a corresponding infringement (as of today there are requirements in CRAR which, even if breached, cannot be enforced) and if fines are based on CRAs' turnover to ensure they have a proportionate and deterrent effect on CRAs of different sizes.

In addition, ESMA recommended that the upper limit of the fines to be imposed should be increased to five times the current level to ensure that they have sufficient dissuasive effect on the largest CRAs (the global revenues of which, in some cases, reached as high as $2.4 billion in 2015[1]). The proportionality of the fines being imposed would still be respected as they would remain subject to the 20% maximum turnover threshold set out in the CRA Regulation.

ESMA is pleased that the Commission shares our concerns regarding the current level of fines, as reflected in its Report[2] of 19 October 2016, which among other issues, assesses the state of the credit rating market including, competition and governance in the credit rating industry.

ESMA also invites the Commission to consider the inclusion into CRAR of amendments equivalent to those proposed for EMIR, where appropriate. We refer, for instance, to: (i) the extension of the type of enforcement decisions that can be adopted by ESMA; (ii) the removal of the requirement for ESMA to obtain judicial authorisation at national level for on-site inspections where there is no opposition from the supervised entity; (iii) the possibility for

[1] McGraw Hill Financial Inc. 2015 revenue: $2428 million. Moody's Corporation 2015 revenue: $2334.2 million. Fitch Group revenue 2015: €1051.5 million. Please note that for McGraw Hill Financial Inc. and Moody's Corporation, 2015 figures include global rating business only whereas figures for Fitch Group includes global rating and non-rating business.
[2] COM/2016/0664 Report from the Commission to the European Parliament and the Council on alternative tools to external credit ratings, the state of the credit rating market, competition and governance in the credit rating industry, the state of the structured finance instruments rating market and on the feasibility of a European credit rating agency.

ESMA to oppose certain material changes to the conditions of registration; (iv) the obligation for CRAs to submit further periodic information to ESMA with a corresponding sanction; and (v) simplifications / clarifications of ESMA's supervisory procedures for CRAs (in line with those described in paragraphs 158-169 of the EMIR Review Report No. 4).

Way forward

ESMA, therefore, invites the Commission to consider the aforementioned amendments to EMIR and CRAR as a matter of urgency. ESMA stands ready to engage in a dialogue and to provide the relevant clarifications and justifications for the proposed amendments.

Finally, ESMA would like to propose to the Commission to consider, within the scope of REFIT, further harmonisation of the supervisory and enforcement frameworks applicable to TRs and CRAs.

Should you have any questions on this letter or the suggested amendments, please do not hesitate to contact me, Rodrigo Buenaventura, Head of the Markets Department or Evert van Walsum, Head of the Investors and Issuers Department.

Yours sincerely,

Steven Maijoor

cc: Ugo Bassi, Director, Directorate C: Financial Markets, DG Financial Stability, Financial Services and Capital Markets Union

ANNEX

1 ESMA's sanctioning powers and the level of TR fines:

1. ESMA welcomes the reference to an increase in the level of the specific fines that can be imposed by ESMA on TRs by ten times to make them more comparable with the ones in place for CRAs and establishment of a floor of 2% with regards to the relationship between the fine and the turnover of the TR.

2. ESMA further appreciates the need for a correction of an oversight in EMIR regarding the amount of the fines in the case of opposition to ESMA's investigatory powers and establishment of fine levels in that instance between 5.000 and 10.000 EUR.

3. ESMA also restates the need to review the mitigating and aggravating factors and in particular to reduce the timespans related to breaches where (i) in Point I (b) of Annex II of Regulation (EU) No 648/2012, "six months" is replaced by "one month" and (ii) in Point II (a) of Annex II of Regulation (EU) No 648/2012, "10 working days" is replaced by "24 hours".

4. In addition, as explained in detail in the ESMA EMIR Review Report No. 4, ESMA requests the extension of the type of enforcement decisions that can be adopted by ESMA similar to the ones already included for national competent authorities in MiFID II (Article 69(k), (f) and (u)) such as (i) the power for ESMA to require the temporary cessation of any practice that ESMA considers contrary to EMIR / SFTR, (ii) the power to adopt any type of measures to ensure that a TR continues to comply with legal requirements under EMIR / SFTR, (iii) the power to impose a temporary prohibition on the acceptance of new reporting counterparties or the extension of the services that the TR offers, when these would compromise the stability or the accuracy of data, and (iv) the power to require the removal of a natural person from the governing bodies of a TR, and finally, the possibility for an accelerated procedure for adoption of enforcement decision, when needed.

5. Finally, to allow ESMA perform its functions on equal ground as national competent authorities, ESMA considers as essential the removal of the requirement for ESMA to obtain judicial authorisation before non-coercive on-site inspections. This requirement is clearly disproportionate in view of ESMA's role as supervisor and can constitute also a discrimination against a European Authority (ESMA) that faces higher requirements for performing an on-site inspection than a National Competent Authority supervising the same entity (in case TR are also registered as service providers) or similar ones (other market infrastructures). We also request the revision of the checks that under Article 63(8) of EMIR are to be performed by the national judge to the supervisory functions of ESMA, which should be able to go on-site even if it has no ground to think that an infringement is taking place.

2 ESMA's supervisory tools

6. Furthermore, ESMA request the inclusion of (i) a possibility for ESMA to oppose material changes to the conditions of registration, (ii) an obligation for TRs to submit periodic information to ESMA and (iii) subsequently, of sanctions for breaches of the obligation to notify periodic information and material changes to the conditions of registration.

7. As described in detail in paragraphs 158-169 of the EMIR Review Report No. 4, ESMA calls for Inclusion of certain simplifications / clarifications of ESMA's supervisory procedures.

8. Furthermore, we seek an extension of the type of enforcement decisions that can be adopted by ESMA and the application of an accelerated procedure for adoption when needed.

9. Lastly, as mentioned in the ESMA EMIR Review Report No. 4, ESMA requests an extension of the timespan of the registration process in order to ensure sufficient time for detailed assessment of the applications.

3 Essential additional TR requirements

10. As per the analysis included in the ESMA EMIR Review Report No. 4, ESMA fully supports an inclusion of additional requirements for TRs to ensure data quality, in particular completeness and correctness of data reported. This requirement is already in place under SFTR making reference to the TR procedures and the operational standards for data collection.

11. ESMA also supports the inclusion of another specific requirement for TR - to have terms and conditions for data access. This requirement is already in place under SFTR.

4 Reporting requirements

12. ESMA appreciates the reference to backloading in the EC EMIR Report and further supports the limitation or removal of back-loading requirements as already in place under SFTR.

13. In line with the ESMA EMIR Review Report, ESMA also requests an alignment with the SFTR logic of reporting the trades by both counterparties, but with certain exemptions for instance for small NFCs.

14. Finally, ESMA considers necessary to retain the requirement to report intragroup transactions, by taking into account that delegation of reporting is possible under EMIR and that in line with the above proposals there would be a possibility for a general exemption for small NFCs.

5 Clearing obligation

17. First of all, ESMA welcomes the first proposal made in the Commission's EMIR Review report, the need to introduce a mechanism to suspend the clearing obligation. The recommendation was made in the EMIR Review Report No.4 and is one that received a lot of support through the multiple consultations on the clearing obligation. In a stressed scenario where a need to suspend the clearing obligation would materialise, time would be of the essence. It is important that the mechanism allowing for the clearing obligation to be suspended provides for a swift and clear decision making process. We believe ESMA is well positioned to assess and decide on such a scenario.

18. Secondly, the Commission's report also addresses the frontloading requirement. On that topic, ESMA would like to reiterate that costs significantly outweigh the benefits. ESMA is of the opinion that the frontloading requirement could be removed while not compromising on the overarching objective of reducing systemic risk. On the other hand, ESMA is of the opinion that intragroup transactions are not free of risks. As a result, it seems appropriate that counterparties are subject to the same requirements for these transactions, including the clearing obligation, unless a series of conditions are met ensuring that their risks are properly mitigated. However, ESMA believes that the wording of Article 3 could be further clarified.

19. Thirdly, following the EMIR Review and more recently the consultation paper and the final report on the clearing obligation for financial counterparties with a smaller volume of activity, we understand that the Commission is suggesting reconsidering the scope of counterparties to be subject to the clearing obligation (as well as for bilateral margining). On this topic, we remain of the opinion that the first priority is to address the problems impeding client clearing and indirect clearing to develop wider. With respect to the Leverage Ratio framework, ESMA welcomes the proposed changes to CRR announced in November 2016.

20. However, other impediments remain, in particular with regards to the possible conflict of law with national insolvency regimes, therefore ESMA is of the opinion that the wording in Article 48 should be improved to provide the levels of protection initially envisaged. This was developed in more details in the EMIR Review Report No.3.

21. Lastly, with respect to small financial counterparties that could benefit from some exemptions, ESMA stands ready to assist the Commission in defining the criteria that could be used to properly identify them. For instance, if these included certain thresholds, these could be the subject of technical standards to include the proper input from stakeholders.

6 Non-financial counterparties

22. The EMIR Review Report No.1 covered an evidence-based analysis of non-financial counterparties (NFC) activity in OTC derivatives, providing in particular granular

information on the markets in which NFCs are the most active or are responsible for a significant share of the activity, and the range in size and volume of NFCs active in OTC derivative markets.

23. Thanks to this analysis, ESMA agrees that there is a large number of NFCs, namely NFC-s, that should benefit from lighter requirements under EMIR, including a different trade reporting requirement, to strike the balance between limiting the burden and still providing accurate and comprehensive transparency on the OTC derivative market, and an exemption from certain requirements such as the clearing obligation.

24. However, the analysis also demonstrated that there are still very large NFCs, NFC+s, whose activity is comparable in size to some important financial counterparties (FC), and which should thus continue to be subject to the same requirements applicable to FCs.

25. As developed in the report, although, from a business perspective, ESMA understands that hedging is an important part of the activity of NFCs, from a regulatory and administrative perspective, removing the hedging criteria alongside a recalibration of the clearing thresholds would enable to only capture the largest NFCs with a systemic share in the OTC derivative markets while limiting the burden on the largest part of NFCs (and for supervision perspective for competent authorities) in their self-classification exercise.

26. On the topic of NFCs, as developed also in the EMIR Review Report No.1, there is a need to review the definition of NFCs in EMIR, as for the moment, many counterparties fall in the NFC definition, although they are of a more financial activity nature, they would fit more adequately in the FC category. This would further help to ensure that the requirements are properly calibrated for FCs and NFCs respectively and according to their profiles.

7 Margin requirements

27. ESMA welcomes the proposals from the Commission's Review Report based on the EMIR Review Report No.2 that for margin requirements, increased transparency and predictability would be welcomed and that other proposals, such as the potential macro prudential use of margins and haircuts are premature to consider, taking into account the recent application of existing anti-procyclicality measures and the lack of crystallised failure in margin standards.

28. Beyond this part from the Commission's Review Report, on the topic of CCP margin, the Commission Delegated Regulation covering the CCP margin related requirements is based on draft technical standards developed by ESMA. As such, ESMA can assess them when necessary and will be able to propose amendments where appropriate and when needed. These are not dependent on the EMIR Review process.

29. Finally, on the topic of bilateral margin requirements for non-cleared trades, ESMA supports the proposal to provide a mandate to national or other relevant competent authorities to approve initial margin models.

8 Third country CCPs

30. ESMA would like to flag one area which was not covered in the Commission's Review Report, but which deserves some further consideration, the system under which Third country CCPs (TC-CCPs) are entitled to provide clearing services in the EU.

31. The review of EMIR provides an opportunity to rethink the approach toward TC-CCPs. Considerations should be given to whether the current system of full reliance on third country rules and supervisory arrangements should be kept, or whether a system as the one applicable in the majority of the third countries should be envisaged. In the scenario the system of equivalence is maintained, due consideration should be given on whether such equivalence determinations should be rather adopted via Regulatory Technical Standards. In addition, considerations should also be given to the fact that in the current recognition process as defined in EMIR there is no provision that allows ESMA to deny recognition on the basis of any material risk emerging from its review of a CCP application, even though the fours conditions of Article 25(2) are met.

32. In the case the current system is maintained, at a minimum, some key improvements to the recognition procedure should be envisaged:
    a. introduce a risk based assessment according to which recognition may be denied;
    b. foresee that the review of recognition under article 25(5) with respect to the extension of activities and services in the Union should be performed ex-ante and not ex-post;
    c. establish that the conditions (a) and (d) in Article 25(2) shall be met before a TC-CCP can submit an application;
    d. reconsider whether for the assessment of the 4 conditions currently envisaged under EMIR, the wider consultation of many European and national authorities is valuable; and
    e. introduce recognition fees to cover for ESMA related costs and avoid that EU taxpayers finance the recognition costs of foreign infrastructures willing to offer services in the EU.