Template for the Responses to the Discussion Paper on the Clearing Obligation under EMIR

How to use this template

This template is made available to stakeholders who wish to answer to ESMA's Discussion Paper on the Clearing Obligation under EMIR, reference ESMA/2013/925.

ESMA wishes to encourage stakeholders to use the template in order to facilitate the analysis of the responses to this consultation. However, ESMA will duly consider all answers irrespective of the format under which they are submitted.

When not commenting on a specific question or section, please kindly delete the corresponding references (i.e. "Question x", "Answer y", "Comments on paragraphs x to y").

The final submission of your answer in word format is preferred.

A. Respondent

Name: Union Asset Management Holding AG

Country: Germany

Category: please use the table below

Category	Please select
Audit/Legal/Individual	
Banking sector	
Central Counterparty	
Commodity trading	
Government, Regulatory and Enforcement	
Insurance and Pension	
Investment Services	x
Non-financial counterparty subject to EMIR	
Regulated markets/Exchanges/Trading Systems	
Other Financial service providers	

Comment by

Union Asset Management Holding AG

ESMA's Discussion Paper on the Clearing Obligation under EMIR, reference ESMA/2013/925

(Interest representative register ID 35378765850-63)

Date: 8 August 2013

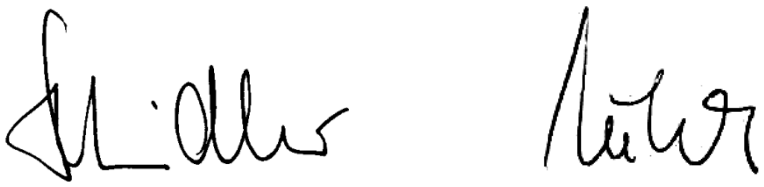
Dear Sirs and Madams,

Union Investment welcomes the opportunity to comment on the ESMA's Discussion Paper on the Clearing Obligation under EMIR.

We are one of the leading asset manager in Germany and asset manager of the German cooperative banking network holding more than € 200 bn assets under management for around 5 million retail and institutional clients.

Please find our specific comments to questions below.

Yours sincerely



Schindler Dr. Zubrod

B. Introduction – General comments

The Union Investment Group, based in Frankfurt/Main, Germany, is one of Europe's leading asset managers holding more than € 200 bn assets under management for retail and institutional clients. Our retail funds are licensed for sale in many European countries. Around 5 million customers are invested in Union Investment retail funds and are benefiting from our extensive range of services. Union Investment offers a wide range of investment solutions in various asset ideas and investment styles: equity, fixed income, money market, alternative investments and quantitative structured funds.

Union Investment welcomes the improvements following EMIR and currently even prepares for a voluntary clearing of some classes of OTC derivatives in 2013. Nevertheless, there are some key concerns that should be considered by ESMA:

1. The "Top-down-Bottom-up approach" considered in Art. 5 EMIR leads to the requirement to define a class of derivatives at such a detailed level that a class of OTC derivatives determined by ESMA in accordance with Art. 5 para. 2 EMIR should only cover OTC derivatives, for which at least one CCP offers clearing. If ESMA intends to capture OTC derivatives for which no clearing is offered yet, it must comply with Art. 5 para. 3 EMIR. As far as ESMA currently intends to define the range of OTC derivatives subject to a class of derivatives further than the clearing offer, this would not only mean a breach of ESMA's obligations under EMIR – it would also mean a product prohibition for certain kind of OTC derivatives. There is no legal authorization of ESMA to establish permanent product prohibitions.

2. Unfortunately it has not been considered yet in Art. 5 EMIR, that Directive 2009/65/EC allows it to establish investment funds in accordance with Contract Law (cf. Art. 1 para 3 of Directive 2009/65/EC). These investment funds do not have a distinct legal personality. Therefore it is always the asset management company in this constellation, who becomes contractual party especially to OTC derivatives. The obligation to segregate the positions of each investment fund (cf. Art. 8 para. 1 of Directive 2010/43/EC) results in respective requirements that a segregation model of a CCP has to meet (with respect to uncleared OTC derivatives there is a separate Master Agreement between the asset management company and the back with respect to each and any investment fund managed). The terms "individual segregation" and "omnibus segregation" are not defined which leads to the result that each CCP follows its own concept in this regard. Unfortunately, national supervisory authorities do not clarify yet which CCP segregation models are in compliance with Art. 8 para. 1 of Directive 2010/43/EC. Therefore, we fear that a class of OTC derivatives becomes subject to a clearing obligation for which no segregation model fulfils the requirements of Art. 8 para. 1 of Directive 2010/43/EC. In consequence investment funds established in accordance with contract law could be excluded from CCP clearing and therefore the usage of the relevant class of OTC derivatives.

3. We still fear that paragraph 42 of ESMAs Guidelines on ETFs and other UCITS issues (ESMA/2012/832EN) hampers UCITS from accessing clearing. The clearing process requires cash for posting variation margin and the said guideline prohibits it to post the purchase price received under a repo as cash collateral to a CCP respectively the clearing member. Since short term limits are limited at 10% of the NAV, it is obvious that UCITS will be hampered to use OTC derivatives subject to a clearing obligation in the volume, especially required for hedging purposes. Since it is obvious that the aforementioned Guidelines are contrary to the goals of G-20 and conflict with EMIR and market participants have raised these concerns numerous times, ESMA should consider whether it either fulfils its obligation under Art. 13 para. 1 EMIR or at least reports a conflict of interest in this regard to the European Parliament and to the Council.

C. Comments on the discussion paper and answers to questions

Comments on paragraphs 1 to 6:

Paragraphs 2 and 3

We believe that according to Art. 5 para. 1 and 2 EMIR, which is considered in para. 2 of the discussion paper, the clearing obligation procedure shall only begin when a CCP, clearing OTC derivatives, is authorised under EMIR, or when ESMA has accomplished a procedure for recognition of a third-country CCP. With this provision, the legislator clearly expresses that establishing a clearing obligation for a specific class of OTC derivatives shall only take place if clearing of this specific class of OTC derivatives is offered and the CCP fulfils al requirements set out in EMIR.

Currently we are facing the problem that neither EMIR nor the applicable Technical Standards consider the regulatory specifics of regulated investment funds such as UCITS. Since the national laws, to be considered when authorizing a CCP, vary in the different Member States, such leads to legal gaps being harmful especially with respect to investment funds being established in accordance with Contract Law (cf. Art. 1 para 3 of Directive 2009/65/EC).

Prior to explaining the existing gaps respectively conflicting requirements, we would like to point-out the aforementioned ratio behind Art. 5 para. 1 EMIR but also ESMAs obligation arising from Art. 13 para. 1 to monitor and prepare reports to the European Parliament and to the Council on the international application of principles especially laid down in Article 4 (Clearing Obligation) in particular with regard to potential duplicative or conflicting requirements on market participants, and to recommend possible actions.

The complexity and variety of the different legal provisions to be considered might be the reason why the conflicting requirements on market participants have not been considered yet.

According to Art. 1 para 3 of Directive 2009/65/EC there are three options regarding the legal structure of regulated investment funds such as UCITS (Contract Law, Trust Law and Statute). Based on this provision, it turned out that in this regard the market practise varies between Member States. In Germany and Luxembourg a significant part of regulated investment funds is established in accordance with Contract Law. These investment funds do not have a distinct legal personality. Therefore it is always the asset management company in this constellation, who becomes contractual party especially to OTC derivatives. Asset management companies are obliged to segregate the investors' assets from their own assets as well as to segregate the assets held in one investment fund from those, held in another investment fund (cf. Art. 8 para. 1 of Directive 2010/43/EC). This obligation is fulfilled by maintaining individual accounts at the custodial bank. Asset management companies, managing investment funds established in accordance with Contract Law enter into OTC derivatives in their own name but for the joint account of the investors of the investment fund determined in the relevant transaction. In light of this legal structure, asset management companies maintain numerous separate Master Agreements with each counterparty.

When it comes to the clearing of OTC derivatives, each CCP offers different kind of segregation models. Generally there are two main groups of segregation: Individual Account Segregation and Omnibus Account Segregation. Art. 39 EMIR includes obligations for CCPs and clearing members with respect to the segregation of clients' assets and positions. Nevertheless, due to a lack of clear definition, the CCPs preparations have shown that the segregation models very much differ from each other, even if they are part of the same group of segregation type.

As stated above, the asset management companies' obligation to segregate assets and positions of different investment funds established in accordance with contract law follows Art. 8 para. 1 of Directive 2010/43/EC but is subject to national law and its interpretation by the local supervisory authorities. Given the fact that a CCP is authorized by the competent authority of a Member State and that authority only has to consider EMIR, the relevant technical standards (neither consider the specifics of regulated investment funds) and the national regulation, asset management companies managing investment funds established in accordance with Contract Law might face the situation that a CCP gains authorisation in Member State A but does not offer a segregation model fulfilling the requirements applied by the competent authority of Member State B on investment funds established in accordance with Contract Law.

Since Art. 5 para. 1 only considers whether a CCP has been authorized and Art. 5 para. 4 EMIR only focus on the characteristics of the given OTC-Derivative, especially investment funds established in accordance with Contract Law could be excluded from the possibility to clear. This would mean a breach of the ratio behind Art. 5 EMIR and furthermore requires ESMA to report these conflicting requirements to the European Parliament and to the Council, as set out in Art. 13 para. 1 EMIR.

A possible action could be that ESMA itself could undertake in order to dissolve this conflict would be, that – prior to submitting draft regulatory standards specifying a clearing obligation for a specific class of OTC derivatives – it obtains a binding confirmation from each competent national authority that at least one of the segregation models offered by the relevant CCP is in compliance with the national segregation requirements to be fulfilled when managing regulated investment funds established in accordance with Contract Law.

According to the ratio of Art. 5 para. 1 EMIR, there should not be any clearing obligation unless the aforementioned conflict of regulations is dissolved.

1. Procedure for the determination of the classes to be subject to the clearing obligation

Comments on paragraphs 7 to 17:

Paragraph 8

ESMA should consider the procedure described above or an alternative to it, in order to ensure that regulated investment funds (such as UCITS) established in accordance with Contract Law are not blocked from accessing CCP-clearing for regulatory reasons.

2. CCP-cleared classes of OTC derivatives

Comments on paragraphs 18 to 30:

Paragraphs 25 and 26

We believe that determining the characteristics of a class of derivatives subject to clearing is one of the most crucial aspects when it comes to consequences of a clearing obligation. We are surprised and concerned about the way, ESMA intends to determine the relevant classes of OTC derivatives:

Neither G-20 nor the legislator of EMIR ever intended product prohibitions.

The "Top-down-Bottom-up approach" considered in Art. 5 EMIR leads to the requirement to define a class of derivatives at such a detailed level that a class of OTC derivatives determined by ESMA in accordance with Art. 5 para. 2 EMIR should only cover OTC derivatives, for which at least one CCP, fulfilling the requirements of EMIR, offers clearing.

If no CCP clearing is offered for a specific class of OTC derivatives, according to Art. 5 para. 3 ESMA is only entitled to publish a "*call for a development of proposals for the clearing of those classes of derivatives*". Only if a CCP is offering the clearing of that specific class of OTC derivatives one day, ESMA shall be entitled to draft regulatory technical standards specifying that class of OTC derivatives as eligible for a clearing obligation.

Any divergence to this clearing procedure set out in Art. 5 EMIR would mean a permanent prohibition of certain OTC derivatives (clearing obligation regarding OTC derivatives for which no clearing is being offered).

In paragraph 25 it reads as follows: "*When defining the essential characteristics to be specified in the RTS, due concentration should be given to the level of granularity of the classes: the more characteristics are used to define a class, the more limited the class will be. [...] It might also create opportunities to evade the CO by entering into contracts which only differ from the once subject to the CO by a minor technical feature*".

We understand that ESMA in this case would breach its obligations under Art. 5 EMIR.

CCPs specify in detail the characteristics of OTC derivatives which can be cleared. According to ESMAs obligations arising from Art. 5 EMIR, ESMA has to determine classes of OTC derivatives for which at least one CCP, fulfilling the EMIR-requirements, offers the clearing. In order to cover only those OTC derivatives which can be cleared, ESMA only would have to copy/paste the characteristics determined by the relevant CCPs. Any discrepancy in the Draft Technical Standards to these specifications would lead to a direct and permanent product prohibition of all OTC derivatives covered by ESMAs specification of the given class of OTC derivative for which no clearing is offered.

We are concerned that any Technical Standard setting-out a clearing obligation for OTC derivatives which cannot be cleared by any market participant would be void because they do not fulfil the requirements under Art. 5 EMIR.

Based on Art. 5 EMIR neither ESMA nor the Commission are authorized to issue permanent product restrictions. Far from it:

The proposals of MiFIR (Markets in Financial Instruments Regulation) set-out the legal framework for a so-called "product intervention". The current draft of Art. 31 para. 1 (b) MiFIR (Proposal of the Council dated June 18, 2013 (11007/13) respectively Proposal of the European Parliament dated October 26, 2012 (P7_TA(2012)0407); both together Interinstitutional File 2011/0296(COD) will provide ESMA with the power to temporarily prohibit or restrict in the Union a type of financial activity or practice. According to the said provision in the current MiFIR Proposals, ESMA will be obliged, prior to any temporary measure, to audit whether a couple of conditions defined in MiFIR are fulfilled.

Besides the clear requirements under Art. 5 EMIR we do not see why ESMA on one hand side requires an explicit statutory power for temporary product prohibitions, whereas ESMA has to fulfil explicit requirements prior any temporary product prohibition, but on the other hand believes that it is entitled to submit Draft Technical Standards considering permanent product prohibitions contrary to the wording of Art. 5 EMIR and without any mandate or statutory power.

We do not agree to the fact that ESMA can justify its approach, not covered by Art. 5 EMIR, with its aim to avoid any circumvention of the clearing obligation. Counterparties do not "play" with characteristics of OTC derivatives. As asset management company we act in the sole interest of the investment funds' investors. Most OTC derivatives are used for hedging market risks the investors otherwise would have to bear. OTC derivatives are agreed "Over-The-Counter", because they are tailored for the specific needs of a market participant. There is always an economic reason behind the terms of an OTC derivative. If there would be an (standardized) exchange traded derivative instead, covering all specific needs, parties would make use of this exchange traded derivative; but there is not.

For the reasons given above and subject to Art. 5 EMIR, ESMA is obliged to define a class of derivatives in a way that it only covers those OTC Derivatives which can be cleared by an authorized CCP. If ESMA intends to submit Technical Standards on OTC derivatives having characteristics which cannot be considered by an authorized CCP yet, it has to comply with the terms set-out in Art. 5 para. 3 EMIR.

2.1 Credit derivatives

Comments on paragraphs 31 to 39:

Paragraph 33

ESMA should consider that some national supervisory authorities are of the opinion that UCITS shall not be allowed to physically receive a loan (as consequence of a credit event for which neither an auction settlement nor a cash settlement takes place). For that reason, UCITS respectively the asset management company acting for the joint account of the investors of a UCITS shall prior to entering into a CDS, agree with its counterparty on a provision by which, differing from the ISDA Credit Derivatives Definitions, in case that a physical settlement takes place and the only deliverable obligation is a loan, a cash settlement shall take place.

Currently ISDA drafts so-called "Additional Provisions" which shall directly apply to all UCITS respectively the asset management company managing UCITS, as well as Non-UCITS for which the parties have agreed via a side letter that the Additional Provisions shall apply accordingly. Those consider the aforementioned matter. Additional Provisions are not only published regarding UCITS.

We believe that it is a key principle of clearing at any CCP (T2 model), that the chain of derivatives following the acceptance for clearing of an OTC derivative, contains of a number OTC derivatives which only differ by the identity of the counterparties. We have doubts that a CCP would be able to clear OTC-Derivatives for which special settlement terms only apply to one of the parties within the chain.

For that reason, we believe that ESMA should consider as criterion whether a CCP is able to consider the afore-mentioned Additional Provisions which only apply to one of the parties of the said chain of cleared OTC derivatives.

Question 1 (Series for Index CDS):

Please indicate your preference between the options presented. Do you believe that the possibility for a new series to exhibit low liquidity is a risk worth being considered when defining the classes of Index CDS? Under Option C, which criteria do you believe are relevant and how should they be calibrated?

Answer 1:

This question is difficult to answer. We are not sure if the suggested automatisms would reflect whether or not (i) an authorized CCP offers the clearing of the new series, (ii) there are specifics like Additional Provisions which require a split into different classes of derivatives, (iii) a market participant requires more time for implementation (e.g. because it has to connect with a new CCP).

Question 2 (Index CDS):

Do you consider that the main characteristics of Index CDS are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?

Answer 2:

No. As explained above (cf. our comment on paragraph 33), we believe that especially ISDA Additional Provisions applying automatically to only some of the market participants and amending the terms of the CDS in a way a CCP might not be able to handle, must be considered.

If there is a regulatory requirement of the relevant market participant (e.g. UCITS) to have these ISDA Additional Provisions applied, not considering the relevant ISDA Additional Provisions as relevant characteristic of the class of derivatives would mean a permanent product prohibition (cf. our comments on **paragraphs 25** and **26**).

We believe that CDS for which Additional Provisions apply should be considered as a different class of derivatives and only be subject to a clearing obligation, if at least one CCP is able to consider those.

Question 3 (Index CDS):

Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?

Answer 3:

No.

Comments on paragraphs 41 to 44:

Question 4 (Single name CDS):

Please indicate your preference between the options presented. In relation to Option B, which geographical zones would you define, i.e. how could the currencies be grouped in geographical zones? What is the standard market practise in this respect?

Answer 4:

ESMA should focus on the ISDA Physical Settlement Matrix and the “Transaction Typs” determined therein. Each Transaction Type should be considered as separate class of derivatives. Any existing Additional Provisions may lead to the circumstance that a class of derivatives is subject to a further split (derivatives of a class with/without Additional Provisions applicable).

Comments on paragraphs 45 to 50:

Question 5 (Single name CDS):

Please indicate your preference between the options presented. Under Option C, which criteria do you believe are relevant and how should they be calibrated?

Answer 5:

As stated above to question 4.

Each OTC-Derivative on a single name CDS refers to the relevant Transaction Type considered in the aforementioned Matrix.

Nevertheless, it is unclear whether a CCP is able to clear all single name CDS referring to a specific Transaction Type. If the clearing at a specific CCP is restricted e.g. by the ISIN of the Underlying, it might be problematic if ESMA creates an automatism: If a market participant uses “CCP A” to cover all single name CDS subject to a clearing obligation, but “CCP B” suddenly is able to clear a specific single name CDS, “CCP A” is not able to clear at that moment, the market participant would have to access “CCP B” and may require a few months up to a year to take all operational and legal burdens.

Question 6 (Single name CDS):

Do you consider that the main characteristics of Single Name CDS are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?

Answer 6:

As explained above, the Transaction Type, as specified in the ISDA Physical Settlement Matrix should be considered as Key characteristic (cf. our response to your questions 4 and 5). A variable to be considered is whether Addition Provisions, published by ISDA apply to either party (especially those currently developed for UCITS).

Question 7 (Single name CDS):

Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?

Answer 7:

No.

2.2 Interest rate derivatives

Comments on paragraphs 52 to 58:

We welcome that ESMA intends to specify different classes of derivatives within the product category “interest rates”. Furthermore, we fully agree to the conclusion that considering the different variables is required to prevent any clearing obligation of OTC derivatives for which there is either no CCP offering clearing services or no liquidity. Any alternative way would have the effect of a product prohibition which is not intended by EMIR.

Question 8 (Interest rate derivatives):

Do you consider that the main characteristics of the interest rate derivatives are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?

Answer 8:

Yes. As we believe that ESMA should consider the specifics, a CCP considers, in order to avoid any factual product prohibitions. It is our understanding that ESMA has created the tables on basis of the specification made by the CCPs.

Nevertheless, there might be further criteria, ESMA did not consider yet:

In IRS-Transactions (but also OTC derivatives on other underlyings) either individually or automatically reference is made to “product related legal frameworks”. With respect to interest rates swaps the product related legal frameworks issued by ISDA differ from those issued by the Association of German Banks. While one of the frameworks allows “negative interest” under certain market conditions, the result under the other framework would be an “interest of zero”. It must remain in the discretion of the parties if they prefer a worst case scenario of receiving zero or of being obliged to pay interest to the other party. It has always been communicated by numerous market participants in earlier consultations that it must remain possible to agree on OTC derivatives in the relevant mother language and to make sure the relevant national laws apply. If ESMA would not consider the legal documentation used by the parties

prior clearing respectively whether a CCP considers that the OTC derivative to be cleared is subject to certain legal frameworks, as further key characteristic, market participants might be forced to enter into the usage of a documentation differing from the documentation written in their mother language. “Forced”, because if a CCP offers clearing but is only able to clear OTC derivatives e.g. agreed on basis of ISDA rules (and automatically transforms any OTC derivatives submitted, subject to a differing legal framework into those subject to the relevant ISDA rules), any clearing obligation would make it impossible to consider e.g. the documentation published by the German Association of Banks. As the aforementioned example regarding IRS demonstrates, it is likely that a number of market participants might be surprised by an unintended payment obligation.

The given example further shows that also the selected documentation has economic impact, and therefore should be considered by ESMA.

Question 9 (Interest rate derivatives):

Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?

Answer 9:

No.

2.3. Equity derivatives

Comments on paragraphs 59 to 70:

Question 10 (Equity derivatives):

Please indicate your preference between the options presented. Under Option D, which criteria do you believe are relevant and how should they be calibrated?

Answer 10:

Option B seems to be the most practical approach. CCPs define equity derivatives, which they are able to clear, by making reference to indices like STOXX or DAX. It is our understanding that EMIR does not intend the prohibition of some kind of OTC-Derivative. For that reason the class of derivatives subject to mandatory clearing should not be defined broader than the offer of the CCPs (please see our comments to paragraphs 25 and 26).

Comments on paragraphs 71 to 73:

Question 11 (Equity derivatives):

Please indicate your preference between the options presented.

In relation to Option B, which geographical zones would you define, i.e. how could the currencies be grouped in geographical zones? What is the standard market practise in this respect?

Answer 11:

If an regulated investment fund having US Corporates as investment target intends to participate in the economic growth of US Corporates without bearing the risk of a decreasing USD, the parties may agree on a call on the US Corporates that the call shall be Quanto but settled in EUR. Any payments under this equity derivate would be protected against a decreasing value of the USD.

This example demonstrates that the settlement currency is not an equivalent to the geographical zone.

Once more, ESMA should only consider the characteristics as specified by the relevant CCP when determining a class of derivatives which shall become subject to mandatory clearing. Otherwise ESMA conjures up unintended consequences following factual product prohibitions, for which ESMA is not mandated (please see our comments to paragraphs 25 and 26).

Question 12 (Equity derivatives):

Do you consider that the main characteristics of Equity OTC derivatives are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?

Answer 12:

No. ESMA should consider the characteristics as specified by the relevant CCP when determining a class of derivatives which shall be subject to mandatory clearing. Otherwise ESMA conjures up unintended consequences following factual product prohibitions, for which ESMA anyway is not mandated (please see our comments to paragraphs 25 and 26).

The table leaves out many of the specifics, relevant for market participants. Some examples:

- Is the CCP able to consider a cap?
- Are the equity options cleared, of European or American exercise style?
- Do the equity options cleared cover Asian equity options (the determined average of the underlyings development is relevant for the payment of the seller to the buyer)?
- Are the equity derivatives, cleared by the relevant CCP cash or physical settled?
- What kind of exotic options, the relevant CCP is able to clear?
- What are the Additional Disruption Events, the CCP offering the clearing of equity derivatives, is able to consider?
- Is the CCP able to offer the clearing of equity derivatives governed by the ISDA Equity Derivatives Definition and/or the Addendum for Equity Derivatives to the German Master Agreement for Financial Derivatives Transactions?

This list of examples can be extended. Nevertheless, the examples might help ESMA to understand that there are more criteria, having economic impact, which are not considered in the table yet. In order to avoid factual product prohibitions, it is indispensable that ESMA determines classes of derivatives on basis of the characteristics which are published by the different CCPs.

Question 13 (Equity derivatives):

Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?

Answer 13:

No.

2.4. Foreign Exchange derivatives

Comments on paragraphs 75 to 78:

As far as OTC derivatives can only be cleared in the US yet, ESMA should be aware that foreign segregation models (e.g. LSOC) might not fulfil the requirements of EMIR respectively the requirements to be considered by UCITS and other regulated investment funds (please see our comments on paragraphs 2 and 3).

Therefore we do not believe that it makes sense considering OTC derivatives which can only be cleared abroad.

Question 14 (FX derivatives):

Do you consider that the main characteristics of the FX derivatives are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?

Answer 14:

No answer.

Question 15 (FX derivatives):

Do you have preliminary views on the specific items of the presented class which would be the best candidates for the clearing obligation, in view of the criteria to be assessed by ESMA, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?

Answer 15:

No answer.

2.5. Commodity derivatives

Comments on paragraphs 79 to 84:

Question 16 (Commodity derivatives):

What is in your view the best approach to specify the underlying assets within each OTC Commodity class?

Answer 16:

No answer.

Question 17 (Commodity derivatives):

Do you consider that the main characteristics of the Commodity derivatives are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?

Answer 17:

Asset managers typically agree on commodity derivatives having either a basket or an index as underlying. The reason for that is diversification of risks but also fulfilling regulatory requirements.

When determining classes of derivatives, it must be ensured that only those commodity derivatives are captured, which can be cleared by a CCP (we assume OTC derivatives having a single commodity respectively a future on a single commodity as underlying). If no CCP is able to clear certain baskets or indices of commodities, OTC derivatives having such a basket or index as underyling should not be subject to any clearing obligation. ESMA should obtain any and all

characteristics from the CCP (including the underyling documentation (Product definitions of ISDA or product definitions of the association of German banks) in order to avoid factual product prohibitions for which ESMA is not mandated (cf. our comments on paragraphs 25 and 26).

Question 18 (Commodity derivatives):

Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?

Answer 18:

No.

3. Preliminary analysis of the readiness of asset classes vis-à-vis the clearing obligation

Comments on paragraphs 85 to 105:

Question 19 (readiness of the classes):

Do you agree with this analysis?

Answer 19:

No answer.

4. Determination of the phase in, and the categories of counterparties to which the CO would apply

4.1. Dates, phase in, categories of counterparties

Comments on paragraphs 106 to 115:

Union Investment welcomes the improvements following EMIR and currently even prepares for a voluntary clearing of some classes of OTC derivatives in 2013. Nevertheless, we have two key concerns regarding the intended determination of classes of OTC derivatives to be cleared at this point:

Unfortunately it has not been considered yet in Art. 5 EMIR that Directive 2009/65/EC allows it to establish investment funds in accordance with Contract Law (cf. Art. 1 para 3 of Directive 2009/65/EC). These investment funds do not have a distinct legal personality. Since legally it is always the asset management company in this constellation, who becomes contractual party especially to OTC derivatives, the obligation to segregate the positions of each investment fund (cf. Art. 8 para. 1 of Directive 2010/43/EC) results in respective requirements a segregation model of a CCP has to meet. Since the terms "individual segregation" and "omnibus segregation" are not defined and local supervisory authorities do not clarify which segregation models are in compliance with Art. 8 para. 1 of Directive 2010/43/EC, we fear that a class of OTC derivatives will become subject to a clearing obligation for which no segregation model, fulfilling the requirements of Art. 8 para. 1 of Directive 2010/43/EC, is offered by the relevant CCP. In consequence investment funds established in accordance with contract law might be excluded from clearing and therefore the usage of this class of OTC derivatives (cf. our comments on paragraphs 2 and 3).

If the clearing of a class of derivatives is only offered by one CCP, we would not have any reservations against accessing this CCP, as long as ESMA has agreed with all competent national authorities upon the eligibility of at least one segregation solution, offered by the relevant CCP, with the requirements specified in Art. 8 para. 1 of Directive 2010/43/EC for investment funds established in accordance with Contract Law (cf. Art. 1 para 3 of Directive 2009/65/EC).

Question 20 (dates, phase in):

What would you consider to be the shortest delay to impose a clearing obligation to a class of OTC derivatives when there are several CCPs available? And when there is only one CCP available?

Please specify in your answer whether the cause of delay is due to operational issues (e.g. time for CCP/counterparties to be ready for the CO) and/or to market issues (e.g. time for a CCP to add a new product to its offering).

Answer 20:

Already reviewing whether the legal framework of a CCP is in compliance with the regulatory requirements, regulated investment funds have to fulfil takes weeks of time. Besides, operationally there are burdens when it comes to CCP-

clearing: It is necessary to establish a separate account with respect to each investment funds (and for operational reasons any segment to an investment fund). Given the huge number of investment funds in Europe it is already in question whether a CCP has the capacity for this high number of accounts to be set up. From the perspective of an asset manager the shortest delay to impose a clearing obligation should be twelve month.

Question 21 (dates, phase in):

What would you consider to be a reasonable delay to allow CCPs which clear the same asset class or a similar Class+ to clear a new Class+?

Answer 21:

No comment.

Comments on paragraphs 116 to 119:

Question 22 (dates, phase in):

What should be the assumption regarding market share which the CCP would have to be able to assume? Should it be requested that each CCP be able to handle the whole volume to tackle the worst case scenario?

Answer 22:

Yes. Our experience from the preparation of a voluntary clearing of OTC derivatives is that the number of investment funds for which a separate account is to be established is an operational challenge. Prior to any clearing obligation it must be ensured that the CCP is able to set up the required number of accounts.

Question 23 (dates, phase in):

What should be the elements (e.g. number of transactions, increase in risks, number of active counterparties, new jurisdiction involved) for ESMA to investigate, after consulting the NCAs responsible for CCPs authorisation, on the ability of the relevant CCPs to handle the expected volume and to manage the risk arising from the clearing of the relevant class of OTC derivatives?

Answer 23:

One element should be that it is ensured that at least one of the segregation models offered by the relevant CCP is in compliance with the regulatory segregation requirements, an asset management company, managing numerous investment funds, each established in accordance with Contract Law (please also see our detailed comment paragraphs 2 and 3).

Question 24 (dates, phase in):

Should there be a default period of [x] months whenever there is a need for a CCP to upgrade its service considering incompressible internal/external validation processes? If not, how to evaluate the time to upgrade services based on the result of the criteria assessment?

Answer 24:

No comment.

Comments on paragraphs 120 to 128:

Question 25 (categories of counterparties):

Please indicate your preference between the options presented. Would you rather use an option that is not detailed here? Under Options B and C, do you agree to base the clearing access approach on the asset class to which the counterparties have access? What should be the date on which clearing access/threshold calculation should be assessed?

Answer 25:

Our preference is Option B.

Question 26 (categories of counterparties):

What would in your view be the appropriate timeframe for counterparties with / without access to clearing in the relevant asset class?

Answer 26:

ESMA should consider that it is not only the setup at the CCP but also the internal setup of the market participant having impact on the amount of time required for getting access. The latter might be less for a bank; instead asset management companies have to adjust all internal systems e.g. required for supervising the counterparty risk, for earmarking the specific kind of OTC-Derivative in order to being able to differ between those transactions remaining uncleared and those becoming subject to clearing.

There is another key aspect, ESMA should bear in mind:

Clearing OTC derivatives does always mean a collateralization with cash collateral (variation margin), but ESMA took away UCITS' main liquidity source, required for being able to post cash collateral to a CCP.

We still fear that paragraph 42 of ESMAs Guidelines on ETFs and other UCITS issues (ESMA/2012/832EN) hampers UCITS from accessing clearing. The said guideline prohibits it to post the purchase price received under a repo as cash collateral to a CCP respectively the clearing member. Since short term limits are limited at 10% of the NAV, it is obvious that UCITS will be hampered to use OTC derivatives subject to a clearing obligation in the volume, especially required for hedging purposes.

When it comes to a new class of derivatives which is aimed to be subject to a clearing obligation, prior to accessing a CCP, the asset management company has to simulate whether it still would be able to use this class of derivative or if the lack of liquidity will hamper the asset management company respectively the UCITS to enter into future transactions falling into this class of derivatives. The potential number of CCPs to be accessed and the potential segregation of collateralisation between different classes of OTC derivatives within a CCP lead to a split of liquidity. If an asset management company respectively UCITS determines that it will be excluded from CCP-clearing based on a lack of liquidity, it will have to audit alternatives if/how market risks can be hedged.

All of the above leads to the requirement of a timeframe of at least 12 month regardless the fact whether a counter-party already accessed clearing or not.

Meanwhile, this key concern on ESMA's Guidelines has been addressed to ESMA numerous times. Since the aforementioned Guidelines are contrary to the goals of G-20 and furthermore are in conflict with EMIR, ESMA should now consider whether it either fulfils its obligation under Art. 13 para. 1 EMIR or at least reports a conflict of interest in this regard to the European Parliament and to the Council.

Comments on paragraphs 129 to 130:

Question 27 (categories of counterparties):

Do you agree that a key factor to take into account when defining the phase in for the counterparties to comply with the clearing obligation will be the number of clearing members offering client clearing services? Is the client clearing capacity of the CCP also a relevant factor? What could be the other criteria?

Answer 27:

Especially market participants with smaller volumes of OTC derivatives to be cleared might face problems finding a clearing member willing to deal with this.

The client clearing capacity of the CCP of course is a relevant factor, especially when it comes to the number of accounts required for onboarding numerous investment funds (cf. our answer to question 22).

4.2. Minimum remaining maturity of the OTC derivative contracts referred to in EMIR Article 4(1)(b)(ii)

Comments on paragraphs 131 to 135:

Question 28 (remaining maturity):

What are your views regarding the calibration of the remaining maturity of the contracts to be subject to the CO? What criteria should ESMA take into account when defining it?

Answer 28:

In case of a phase-in approach ESMA at least should consider that parties to the relevant OTC-derivative could be subject to different phase-in level. Therefore, it would make sense to determine a minimum remaining maturity which at least considers the latest point in time at which market participants become subject to a clearing obligation.

5. The clearing obligation in specific cases

5.1. Contracts concluded with Covered Bond issuers

Comments on paragraph 136 to 138:

Question 29 (covered bonds):

Are there other specific features of the contracts concluded with covered bond issuers or with cover pools for covered bonds, to be considered by ESMA in the context of the clearing obligation?

Answer 29

No comment.

Question 30 (covered bonds):

What would be the legal or technical challenge faced by covered bonds issuers and CCPs, if a clearing obligation was imposed on some of the OTC derivative contracts included in the cover pools of covered bonds?

Answer 30

No comment.

Question 31 (covered bonds):

Have CCPs developed solutions to be able to differentiate the derivative contracts of the issuer from those of the cover pool?

Answer 31

Not known.

Question 32 (covered bonds):

Would an appropriate phase-in for these counterparties alleviate these challenges? If so, how?

Answer 32

No comment.

5.2. Foreign exchange OTC derivatives

Comments on paragraphs 139 to 140:

Question 33 (FX derivatives):

Within the foreign exchange asset class, for which type of contracts do you consider that settlement risk is the predominant risk, and what criteria or characteristics should be used by ESMA to identify those contracts?

Answer 33:

Market participants use systems like CLS to reduce the settlement risk of certain types of FX derivatives. ESMA should avoid determining a clearing obligation with respect to all classes of derivatives which can be settled through such systems.

5.3. Interaction of portfolio compression and the clearing obligation

Comments on paragraph 141:

Question 34 (Portfolio compression):

Are there ways in which the imposition of the clearing obligation in the EU could hamper the effectiveness of compression services? If so, please provide evidence of the potential impact. Are there ways in which exclusions to the clearing obligation could be defined which alleviate the problem without creating opportunities for avoidance?

Answer 34:

No comment.

5.4. How to withdraw a clearing obligation on a class or subset of it?

Comments on paragraphs 142 to 148:

Question 35 (Modification of a Class+):

For which reason (other than the fact that a CCP does not clear it any longer) do you believe that the clearing obligation of a class - or subset of it - would need to be removed? Please focus on the risks which could stem from a clearing obligation on contracts which would no longer be appropriate for mandatory clearing and provide concrete examples.

Answer 35:

It would need to be removed because otherwise the result would be unintended side effects following a factual product prohibition for which ESMA is not mandated (cf. our comment on paragraphs 25 and 26).

Question 36 (Modification of a Class+):

In case a clearing obligation would need to be reviewed, how crucial would be the time needed to dis-apply the clearing obligation?

Answer 36:

We would suggest it should be the day on which the last CCP stops offering clearing of a class of derivatives, at which any clearing obligation concerning this specific class of derivatives should cease to exist.

Nevertheless, ESMA should consider that if there is more than one CCP offering the clearing of a specific class of derivatives and all of these CCP announce to stop clearing, there should not be an obligation of market participants to access a CCP which shuts-down is service e.g. two month later (in the given example, we assume that it will not be possible anymore to access the other CCP within these two months).

Therefore, ESMA should review immediately after it gets knowledge of a CCPs intention to stop the clearing of a specific class of derivatives, whether, if asked again, it would determine the relevant class of derivatives as clearing eligible when drafting Technical Standards. If ESMA would answer this question with “no”, the relevant clearing obligation should cease to exist on the day, clearing services end for this class of derivatives at the CCP that made this announcement latest.