Association des Banques et Banquiers, Luxembourg
The Luxembourg Bankers' Association
Luxemburger Bankenvereinigung

Response from the ABBL to the ESMA Consultation on:
Consultation Paper on Draft regulatory technical Standards on contracts having a direct, substantial and foreseeable effect within the Union and non-evasion of provision of EMIR

Information about the ABBL:	
ABBL ID number in the COM Register of interest representatives: 3505006282-58	
Identity	Luxembourg Bankers' Association, the ABBL
Capacity	Industry trade body
MS of establishment	Luxembourg
Field of activity/ industry sector	Banking & other financial services
Contact persons	Benoit Sauvage sauvage@abbl.lu Aurélie Cassou (aurelie.cassou@abbl-alfi.lu)
Website	www.abbl.lu

Introduction and general remark

The ABBL[1] welcomes the ESMA discussion paper and invites ESMA to adopt a pragmatic approach, bearing in mind that this document will aim at regulating transactions between entities that are not directly connected to the EU and in most cases for products that are dealt on a private basis (OTC). This raises at the very least three concerns one is the extraterritorial nature of the regulation and conflicts with "host regulation", then what is the obligation of 3rd country entities that have no link with the Union but trade on a private basis on derivatives with an EU underlying and what could be the sanctions applicable for counterparties outside the EU "control" zone.

One aspect that is as well missing from this consultation at least in the technical comments is the fact that given EMIR stems from a G20 agenda item the approach to supervising and regulating OTC derivative trades is global so that some counterparties/products will as well be regulated by other jurisdictions. Namely reporting to a trade repository can be done in the US or in the EU, the Association understanding

[1] The Luxembourg Bankers' Association (ABBL) is the professional organisation representing the majority of banks and other financial intermediaries established in Luxembourg. Its purpose lies in defending and fostering the professional interests of its members. As such, it acts as the voice of the whole sector on various matters in both national and international organisations.

The ABBL counts amongst its members' universal banks, covered bonds issuing banks, public banks, other professionals of the financial sector (PSF), financial service providers and ancillary service providers to the financial industry.

was that it was enough to report a trade to one's preferred TR to satisfy the regulation objectives. The coordination and sharing of information will be done between relevant authorities (a consideration currently subject to a BIS paper).

Although the ABBL shares the view that try to avoid this regulation through fake or illicit transactions shall be forbidden and sanctioned, the issue is how to design the border line, what is the trigger and why is a transaction infringing this regulation, in that the Association is of the view that the wording used may be a bit too systematic and lack some practicalities.

Then be it in the case of branches or subsidiaries, EU supervisors and regulators shall bear in mind that these entities are more likely than not equally subject to local regulations. If they have to abide by both the EU and there local regulation compared to entities located in that 3rd country EU institutions will always be put at a disadvantage by the dual or multiple reporting/compliance rules for a same instruments. This adds at a global level risks of dual or multiple counting for a similar transaction. EMIR was born as a consequence of a G20 demand just like for example Dodd-Frank, it may be considered that in cases where an entity has to comply to Dodd-Frank Act it complies as well to EMIR regulation, in the case of EU entities at least.

Specific answer

Q.1 Do you agree that a full or partial guarantee issued to the benefit of a third country counterparty by an EU guarantor, whatever is its form, be considered in order to specify the direct, substantial and foreseeable effect of the contract?

Q.2 Do you agree with the 2 cumulative thresholds proposed in the draft RTS? Do you consider that the proposed value of the thresholds is set at an appropriate level in order to specify the direct, substantial and foreseeable effect of the contract? Please provide relevant data to justify your answer.

The approaches proposed seems to make sense, however the reference to the notional amount may add an increasing supplementary dose of penalisation for products that are out of "in the market" prices. Indeed the notional value may be much higher than the amount exchanged (premium) and thus represents additional penalisation. Furthermore the reference to gross exposures will not take into account "close out netting effects" or off-setting positions or trades. This implies an additional and perhaps excessive penalisation.

In addition one has to assess which types of impact there may be and at which level. Will the impact be felt on the underlying (the object of the derivative) or on the counterparty? The Association believes that increasing the materiality threshold from 5% to 10% per counterparty may be more representative, in fat this would put in line with entities having a close link as used in other EU rules.

And in the end the notion of “guarantee what ever its form” is extremely wide and as the terms have not been defined one may legitimately question what is a guarantee? Is for example a close-out netting a form of guarantee, the ABBL thinks not in this case.

Q.3 Do you agree that OTC derivative contracts entered into between two EU branches of third country entities would have direct effect within the Union?

Yes, although these are representation of an entity located in a 3rd country, because they are “physically” done in the EU on EU instruments they shall be caught. Furthermore from a prudential perspective non-EU branches are subject to the prudential requirements of the EU, as this discussion centres on systemic risk protection the ABBL feels they may be covered. Ideally reporting of transactions shall be clarified, which TR will be used, the parent company one or the EU available one?

This said, there may be an effect, but only systemic risk shall be taken into account, thus only transactions above a given threshold that may materially impact either the counterparty or the underlying instrument.

Q.4 Do you agree that criteria related to the currency or underlying of the OTC derivative contracts should not be used to specify the direct effect of the contract within the Union?

The ABBL would tend to agree that the definition of the currency to the contract is not prima facie relevant, that position is not the same vis-à-vis the underlying instrument. A prerequisite for an EU foreseeable direct impact is that either one of the counterparty is in the EU or that the underlying reference is EU based and the size of the transaction may create systemic risks.

Q.5 Do you agree that contracts of third country subsidiaries of EU entities would not have a direct substantial and foreseeable effect within the EU?

It depends on the nature and size of the exposure. In the first question with the guarantee model, the EU institution is impacted by a link with its counterpart. In this case from a legal point of view the subsidiary in 3rd country X may report to the local authority and be under their supervision… but this approach would not take into account reputational risk and the low likelihood that a major EU institution will simply drop one falling subsidiary. The question here is more what size shall be the trigger for a materiality impact on an EU parent company, the large exposure regime from the CRD may give some hints in that respect.

Q.6 Do you believe that in absence of a guarantee, there is limited implicit backing by the EU parent of a third country subsidiary that can result in a direct, substantial and foreseeable effect in the EU?

In line with the previous response, yes, there may be an impact. The question is will it be substantial or not and will the parent company be able to support it? The ABBL considers that generally speaking the impact may be relatively moderate notably because other 3rd country jurisdictions will put in place similar requirement as the EMIR and local entities will then be supervised accordingly, in addition banks will be under much stricter rules from Basel III or under resolution/living wills program which will force them to forecast this type of risks. Concretely although there may be an impact from the EMIR there may be no reasons to add rules above the current prudential environment.

Q.8 Do you agree that the acceleration of the obligation of listed entities resulting from the OTC derivative contract should not be considered to specify the direct, substantial and foreseeable effect of the contract?

No, one major reason to oppose is that of treasury management, it is not the same as being subject to X, Y, Z obligations in 3 months, 6 months and 2 years as being forced to comply today. What Basel III has introduced is a focus on liquidity management short and long/medium term. In this case depending on the size of the obligation, which is not discriminated here, the impact can be low or nil up to substantial and life threatening.

Q.9 Do you agree with a criteria based approach in order to determine cases where it is necessary or appropriate to prevent the evasion of any of the provisions of EMIR?

Contrary to ESMA, the ABBL would prefer a list of transactions that are forbidden or suspects rather than a list subject to interpretation

Q.10 Do you agree that artificial arrangements that would have for primary purpose to avoid or abuse of any provision of EMIR should be considered as cases where evasion of provision of EMIR should be prevented?

From a theoretical perspective it is difficult to oppose to the statement in this question, however some attention shall be drawn to the content of the criteria and what makes an abusive transaction, notably competitive positions versus non EU Institutions. Business, treasury management, or else may lead to perform some, many or most transactions from an otherwise unexpected location. Furthermore the reference to “back-to-back” transactions (a similar transaction in two opposite direction) will have major implications against hedging, which are basically transactions in an opposite direction to a previous one. From a practical standpoint the reference is made to transactions with no apparent purposes, the issue may be how will judge that these are purposeless…

Another element to consider, although it may be stretching the argument a bit, is that there is a treasury management impact of applying EMIR and avoiding some transaction under that regime may be more advantageous from a cash/treasury management stand point, which would prove good for CRD/prudential matters, the ensuing question is which is best applying EMIR fully with costs or improving the profile on the prudential side?

Comments on the RTS proposal

The Association would like to stress the very open and subjective wording used under article 3.2 where space for interpretation is to wide, the issue being who will decide and how to ensure consistency of decisions across one jurisdiction and across the Union as a whole.

Then as formulated article 3.3.c will point to hedging of transactions that are deemed to lower the risk profile, this shall either be removed or reworded.