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

Luxembourg, 14th August July 2014

ABBL[1] response to ESMA Consultation Paper on the Clearing Obligation under EMIR (no. 1)

Information about the ABBL (Luxembourg Bankers' Association):	
Identity	Professional Organisation
Capacity	Industry trade body
MS of establishment	Luxembourg
Field of activity/ industry sector	Banking & other financial services
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Introductory comments

The ABBL welcomes ESMA for the opportunity to comment on this document which overall is heading in a right direction, however the Association is a bit surprised by both the timing and length of consultation. The ABBL in some respect is hopeful that this bottom-up approach will remain the standard for the future notably if firms have so few time to test the proposals, this said even if in this case stakeholders have already largely opted for clearing.

The ABBL stresses the idea that if a product shall be mandatorily cleared at some stage it must be doable on at least 2 CCPs, which has several consequences. First as pointed in the consultation paper, clearable instruments of similar nature across CCPs shall not be subject to specific authorisation procedure. Then once a product is removed from the clearable products it shall be so immediately, in addition if a product is cleared in the future by only one CCP the mandatory clearing shall cease, which does not mean it is forbidden to clear it. Then ensuring that several CCPs offer a similar service ensures that portability obligation of EMIR is applicable.

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.

1. The clearing obligation procedure

Question 1: Do you have any comment on the clearing obligation procedure described in Section 1?

The ABBL shares ESMA's approach to grouping asset classes and consult based on this categorisation. This would help market participants to form a better view of the effects of clearing and improves the consultation process instead of requiring separate authorisation.

2. Structure of the interest rate derivatives classes

2.1 Characteristics to be used for interest rate derivative classes

Question 2: Do you consider that the proposed structure defined here for the interest rate OTC derivative classes enables counterparties to identify which contracts fall under the clearing obligation as the well as allows international convergence? Please explain.

In a global market by design, consistency and convergence are essential, the ABBL welcomes ESMA intent to facilitate the process.

The ABBL supports ESMA proposal on page 24 vis-à-vis new products subject to mandatory clearing, in the future they shall be consulted separately. This said, attention to product characteristics remains key, high level product specifications may not be enough and in the end it would create confusion in the market.

2.2 Additional Characteristics needed to cover Covered Bonds derivatives

Question 3: Do you consider that the proposed approach on covered bonds derivatives ensures that the special characteristics of those contracts are adequately taken into account in the context of the clearing obligation? Please explain why and possible alternatives.

Stakeholders (CCPs and covered bond derivatives users, in particular) are invited to provide detailed feedback on paragraph 38 above. In particular: what is the nature of the impediments (e.g. legal, technical) that CCPs are facing in this respect, if any? Has there been further discussions between CCPs and covered bond derivatives users and any progress resulting thereof?

For the ABBL the approach retained for covered bonds derivatives is broadly satisfactory, the specificities of these instruments and their positive impact on the EU economy shall be preserved or duly taken into account. Probably some fine-tuning could be done to further facilitate a workable approach not only in mandatory clearing but also for non-centrally cleared derivatives.

Regarding point 54 (f) the ABBL believe it should be sufficient to have a de facto 2% over collateralisation and not a necessity to have legal requirements in each jurisdiction.

To ABBL reading, clearing and risk management procedures apply when at least 2 counterparties are involved, a contrario transactions done within the same entity do not have to comply (ESMA EMIR Q&A Q14 in TR section). Hence in accordance with national legislation and upon prior approval by its competent authority when a bank issues covered bonds on its own balance sheet and internally hedges the risks relating to such covered bond issues, all such hedging arrangements are made within the same legal entity, therefore the need to clarify that the RTS does not apply to such internal hedging transactions.

2.3 Public Register

Question 4: Do you have any comment on the public register described in Section 2.3?

In the ABBL opinion, ensuring orderly market trading and clearing to avoid systemic risk is the reason why EMIR was released, some products will have to be mandatorily cleared, others not. The reasons why they are not is because of their intrinsic market structure, be it lack of liquidity or the tailor made nature of the contracts, forcing a contract to clear when the market structure is not appropriate means simply transferring risk onto a CCP that in many likelihood it will not be able to hedge. It is thus of prime importance to remove product from mandatory clearing as swiftly as possible and inform the entire market from a central point.

The removal of the mandatory clearing obligation also triggers some questions whereas the risk mitigation requirements otherwise applicable to non-cleared OTC derivatives or proposing grace period for putting in place the relevant arrangements for the new trades and of course procedures to “manage” the stock of open positions with the different counterparties.

That may be a field for the upcoming EMIR review, however it is likely that the timeframe will not be aligned with the moment when EMIR finally comes fully to life with all requirements from reporting until mandatory clearing or margining requirements. In this respect it is nearly fortunate that EMIR will be fully live nearly 3 years after its implementing date.

The ABBL is of the opinion that mandatory clearing shall only arise when at least 2 CCPs offer clearing in that particular instrument in the same currency (ideally), these are 2 different things of being either clearable or mandatorily clearable. Mandatory clearing on a single platform increases systemic risk of failure and place counterparties into unequal price negotiation positions, it would be equivalent to a monopoly and because EMIR left to ESMA to define eligible products it implies no need to force clearing on a single CCP.

More practically, the ABBL understands that the banks should organise the periodical screening of the indicated web page.

To help the banks being updated, could ESMA commit itself to pre-announce publicly via press or via the industry representative institutions or via the NCA, that a new modification is about to be released.

3. Determination of the OTC interest rate classes to be subject to the clearing obligation

Question 5: In view of the criteria set in Article 5(4) of EMIR, do you consider that this set of classes addresses appropriately the systemic risk associated to interest rate OTC derivatives? Please include relevant data or information where applicable.
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The ABBL would like to remind ESMA that in many jurisdictions, the derivatives traded locally may not be subject to ISDA master agreement but to local or in-house standards, are these to be considered standardised for EMIR purposes? From this issues derives a second one which that portage of contracts from one CCP to another may not be that easy in practice, if one takes the case of IRS probably that LCH.Clearnet concentrates most of the transactions over a hand few of clearing members. How shall it workout once a client wants to switch or if a clearing member fail, how to ensure that the segregated structure at one CCP/participant is preserved…? There may be such discrepancies in terms of size between that entity and others that the idea of establishing connections to arrange back-ups clearing may not work as expected in the paper. Furthermore, market practices are changing over time (e.g.: use of LIBOR / EURIBOR), how ESMA will adapt to such evolution in order to maintain a consistent list of products over time.

In addition to the exception of the largest global players the reality is that because of regulatory uncertainty many medium and small sized institutions have delayed their analysis if they shall be/remain clearing member. The operational cost and complexity may disincentivise these firms setting up segregation requirements, introducing new account structuring and obligations to clear that are required. The ABBL as a consequence is reserved whereas the outcome of the proposal.

4. Determination of the dates on which the obligation applies and the categories of counterparties

4.1 Analysis of the criteria relevant for the determination of the dates

Question 6: Do you have any comment on the analysis presented in Section 4.1?
The ABBL does not agree, the analysis is too theoretical and does not take into account all factors. For example if only one CCP clears a product how could participants and their clients prepare BCP/DRP, shall participants and clients switch to bi-lateral collateral exchange, if so what to do with amount posted with the CCP. These are not impossible to solve problems, however templates shall be provided as it is likely that such events mean large failure.

4.2 Determination of the categories of counterparties (Criteria (d) to (f))

Question 7: Do you consider that the classification of counterparties presented in Section 4.2 ensures a smooth implementation of the clearing obligation? Please explain why and possible alternatives.

The ABBL welcomes the principle of granting delays to adapt but concretely the association is not convinced that the approach will work. Practically speaking two issues need to be resolved first the one of “attraction” of trades into category 1, the difference between trades for clients, own account and direct members of clearing members is not very clear. The ABBL sees a clear risk of confusion between category 1 and 2 that will in the end lead to forcing all entities to converge to the 6 months deadline. Then assuming that the split between trades is done then it may create competition issues between participants of the category 1 and the category 2 for example how to price hedging transactions between the category 1 banks and category 2?

As there will be client interactions this means that the process will have to be documented, probably subject to client information and agreement, which translate into costs for a transitory period, the Association would prefer a more streamlined process.

Lastly the tiering of market participants may not always be meaningful, the ABBL invites ESMA to analyse first how markets are organised today in the case of IRS the recourse to CCPs is already very high among all client categories (at least at FC level).

4.3 Determination of the dates from which the clearing obligation takes effect

Question 8: Do you consider that the proposed dates of application ensure a smooth implementation of the clearing obligation? Please explain why and possible alternatives.

Several factors enter into play on deciding on the most optimal approach. In the case of IRS market stakeholders are already relying on clearing, at least for the category one and two this would be an argument for a "short" delay in that respect the 6 months envisaged appear satisfactory. That said these stakeholders are not the entire market and there is a need to take into account of a sufficient delay before the market fully move to the new standards set by the RTS.

Furthermore, the scope of products covered by the IRS category may be extremely large and if the procedure is extended to other derivatives it may be difficult to use different timelines as a consequence the Association would propose to rely on a 12 months delay in all cases so that it is workable for all market participants at all level. In other words the proposal addresses the need of CCP direct participants but not the ones in categories below, what would be the contractual consequences for contracts that are otherwise bilaterally arranged?

5. Remaining maturity and frontloading

Question 9: Do you consider that the proposed approach on frontloading and the minimum remaining maturity ensures that the uncertainty related to this requirement is sufficiently mitigated, while allowing a meaningful set of contracts to be captured? If not, please explain why and provide possible alternatives compatible with EMIR.

The ABBL welcomes the clarification that contracts concluded with non-financial counterparties are not subject to frontloading obligation. The ABBL supports the decision to limit frontload only to a limited number of contracts within Period B.

The ABBL thinks that the difficulty with frontloading will not come from the operation in itself but from the fact that doing so implies as well changes regarding collateral switching it from one place to another with potentially diverging rules (would it only be with regards to the "conversion" of margins, initial and variation, to CCP collateralisation procedures.

There are other practical issues to consider like this might generate confusion when pricing IRS with Category 2 counterparties during Phase B. if one assume a Category 2 counterparty enters into an IRS during Phase B with a remaining maturity greater than 12 month, at the time of execution it is bilateral ISDA contract that then needs to be

front-loaded which will also change its status from a non-cleared product to a cleared one which impacts its pricing and risk valuation, at this stage it is not clear how these can be handled.

6. OTC equity derivative classes that are proposed not to be subject to the clearing obligation

Question 10: Do you have any comment on the analysis on the Equity OTC derivative classes presented in Section 6?

The analysis seems fine for the ABBL.

7. OTC Interest rate future and option classes that are proposed not to be subject to the clearing obligation

Question 11: Do you have any comment on the analysis on the OTC Interest rate future and options derivative classes presented in Section 7?

The Analysis seems fine for the ABBL

1 Annex I - Commission mandate to develop technical standards

2 Annex II - Draft Regulatory Technical Standards on the Clearing Obligation

Question 12: Please indicate your comments on the draft RTS other than those already made in the previous questions.

No specific comments as they reflect the content of the consultation paper.

3 Annex III - Impact assessment

Question 13: Please indicate your comments on the CBA.

It is in line with the discussion in the consultation paper.