esma European Securities and Markets Authority

Reply form for the consultation paper on indirect clearing arrangements under EMIR and MiFIR

5 November 2015

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the questions listed in this Consultation Paper on Indirect clearing arrangements under EMIR and MiFIR, published on the ESMA website.

Instructions

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

- use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
- do not remove the tags of type <ESMA_QUESTION_RTS_INDIRECT_CLEARING_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- if you do not have a response to a question, do not delete it and leave the text "TYPE YOUR TEXT HERE" between the tags.

Responses are most helpful:

- if they respond to the question stated;
- contain a clear rationale, including on any related costs and benefits; and
- describe any alternatives that ESMA should consider

Naming protocol

In order to facilitate the handling of stakeholders responses please save your document using the following format:

ESMA_ RTS_INDIRECT_CLEARING_NAMEOFCOMPANY_NAMEOFDOCUMENT.

E.g. if the respondent were XXXX, the name of the reply form would be:

ESMA_RTS_ INDIRECT_CLEARING_XXXX_REPLYFORM or

ESMA_RTS_ INDIRECT_CLEARING_XXXX_ANNEX1

To help you navigate this document more easily, bookmarks are available in "Navigation Pane" for Word 2010 and in "Document Map" for Word 2007.

Deadline

Responses must reach ESMA by **17 December 2015**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input/Consultations'.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading Legal Notice.

Introduction

Please make your introductory comments below, if any:

<ESMA_COMMENT_RTS_INDIRECT_CLEARING_1>
[Chicago Mercantile Exchange Inc. ("CME") and CME Clearing Europe Limited ("CME Clearing Europe"), wholly owned subsidiaries of CME Group Inc. (together "CME Group"), appreciate the opportunity to comment on ESMA's Consultation Paper of 5 November 2015 regarding indirect clearing arrangements (the "Consultation Paper"). CME Group Inc. is the parent company of four Designated Contract Markets ("DCMs"): CME, the Board of Trade of the City of Chicago, Inc. ("CBOT"), the New York Mercantile Exchange, Inc. ("NYMEX"), and the Commodity Exchange, Inc. ("COMEX"). These DCMs offer the widest range of benchmark products available across all major asset classes, including futures and options based on interest rates, equity indexes, foreign exchange, energy, metals, agricultural commodities, and alternative investment products. CME's clearing house division ("CME Clearing") and CME Clearing Europe offer clearing and settlement services for exchange-traded futures contracts and over-the-counter ("OTC") derivatives. CME Clearing Europe is regulated and supervised by the Bank of England as an authorised central counterparty under the European Market Infrastructure Regulations ("EMIR"). CME Europe Limited, a London-based, FCA-supervised derivatives exchange and MiFID regulated market. CME Clearing is registered with the CFTC as a Derivatives Clearing Organization ("DCO"), has been deemed a systemically important financial market utility by the Financial Stability Oversight Council and is in the process of becoming recognised under EMIR.

We welcome the fact that ESMA has taken account of certain of the industry's feedback in relation to indirect clearing and sought to align the approach for exchange traded derivatives ("ETDs") with OTC derivatives. While it is primarily for clearing members and clients to confirm whether the changes resolve their concerns, we nonetheless have a number of comments on ESMA's proposed regulatory technical standards as set out in the Consultation Paper (the "draft RTS"), including some suggestions for improvements and requests for clarification, a number of which we believe are shared with a significant number of market participants.

We understand and applaud the goal of the indirect client clearing consultation to provide robust protections to indirect clients. Unfortunately, the indirect clearing regime, as currently constructed, will reduce the ability of indirect clients to access foreign markets and EU brokers to retain their current EU client relationships in such markets. Such a result will hamper the ability of these clients to manage their risk and reduce their ability to compete in the global financial markets.

We consider the protections for indirect clients that are proposed in the draft RTS are unnecessary given the protections already ensured for indirect clients when they access third country markets and CCPs that are recognised under the existing legislative framework in MiFIR and EMIR. By imposing additional requirements under the daft RTS for markets and CCPs which have been granted recognition, ESMA is undermining the policy objective behind the equivalence process under the existing EU regulatory framework.

While we recognise that ESMA wishes to ensure that indirect clients are provided appropriate protection, we believe that the draft RTS would in fact have the opposite effect. Under ESMA's proposal, indirect clients will likely be forced to become direct clients of clearing members – an arrangement which may not be appropriate for them – or be forced to cease accessing the markets they currently choose to use for risk management purposes.

Our feedback on each of the specific questions raised by ESMA in the Consultation Paper is set out in our responses to those questions but we also provide below a summary of our key concerns and the major themes set out in these responses:

Proliferation of accounts throughout the chain

The draft RTS currently provide that a clearing member would be required to open a separate net omnibus segregated account ("NOSA") and / or gross omnibus segregated account ("GOSA") at the CCP in respect of each client holding the assets and positions of its indirect clients. This requirement would give rise to a proliferation of accounts throughout the indirect clearing chain which will raise the cost and operational complexity of indirect clearing at all levels of the chain.

While this is primarily an issue for market participants at the clearing member, client and indirect client level, we understand that it would be an acceptable position for clearing members to hold a single GOSA / NOSA at the CCP and clearing member level to hold the indirect client positions of all of the indirect clients of the clearing member. We request that ESMA consider this model as a potential alternative model in order to reduce the number of accounts and associated operational complexity.

Need for clarification on accounts and the roles of CCPs

We recommend that ESMA should provide additional detail or clarification around the nature and characteristics of the GOSA which we believe would be necessary in order for CCPs to develop the model. It is not clear the extent to which it is proposed that there is fellow customer risk under the model and there are also uncertainties around the requirements for treatment of excess collateral. We also require additional clarification on the role of and requirements on CCPs holding the assets relating to the indirect clients' positions in certain default scenarios, for example, on a joint client and clearing member default. We assume that it is not intended that CCPs would also need to put in place a legal mechanism to enable them to return assets directly to the indirect client (by way of an extended "leapfrog payment") but we kindly request that this be clarified.

Scope and application to third country participants

In respect of the ETD market, in which the overwhelming majority of products are already subject to central clearing on standardised models, we consider that the impact of the proposals set out in the draft RTS could be disruptive and may have consequences that are not identified or acknowledged in the Consultation Paper, particularly for market participants accessing third country markets or in chains involving third country market participants. We understand that ESMA is aware of these issues on the basis that the same points have been identified and discussed in previous responses to consultations on this topic by market participants, including by CME Group, in response to

ESMA's Consultation Paper on the Markets in Financial Instruments Directive and the Markets in Financial Instruments Regulation of December 2014.

In particular, we are concerned that under the draft RTS an indirect client established in the EU would be prohibited from participating in an indirect clearing arrangement that involves a third country client, clearing member, or CCP where conflicts exist between the draft RTS and the applicable local insolvency law framework or account structure regulations, notwithstanding the fact that such framework and protections may be adequate and considered as having equivalent effect.

While ESMA recognises in the Consultation Paper the likelihood of conflicts of law and also that "the EU legal framework cannot override the third country insolvency regime", ESMA does not appear to acknowledge that if an indirect clearing chain involves a third country firm and such a conflict of law exists, then the text in draft RTS suggests that such an arrangement would not be "permissible". In effect, ESMA's draft RTS would have the effect of preventing indirect clients established in the EU from participating in markets outside the EU.

In order to address these issues we recommend that ESMA should limit the application of the RTS to ETD indirect clearing chains that relate to transactions that take place on EU regulated markets and cleared through EU CCPs. It should be noted that such an approach would be consistent with the principles behind the current approach adopted in relation to EMIR, in particular in ESMA's Q&A under EMIR which provide that EU clearing members are not required to comply with the EMIR Article 39 segregation requirements when offering client clearing on third country CCPs on the basis that the relevant third country CCP has been recognised as meeting equivalent requirements to EMIR under the process set out in Article 25 of EMIR.

As an alternative, it may be an acceptable approach to exempt from the requirements of the RTS indirect clearing chains that exist where "exchange traded derivatives" (within the meaning of MiFIR) are traded on a third country market that is deemed to provide equivalent protection to an EU venue under MiFIR Article 28(4) and which are cleared by a third country CCP that is recognised under EMIR Article 25 as meeting the relevant equivalent requirements. The requirements applicable to such a trading and clearing arrangement would have been deemed to have "equivalent effect" to the MiFIR requirements in accordance with Article 30(1) MiFIR and should therefore be considered "permissible", notwithstanding that they may not provide the exact protections set out in the RTS.

In relation to OTC derivatives, we are concerned that the effect of the draft RTS is such that indirect clients would be prevented from using EMIR recognised third country CCPs in order to satisfy the clearing obligation. This is contrary to the principle behind the EMIR recognition regime, where it is acknowledged that third country CCPs will provide client clearing services in accordance with applicable local requirements[1]. It follows that indirect clearing should operate in the same manner, such that the third country CCP recognition process must be considered as demonstrating that the CCP provides protection with equivalent effect to that referred to in Articles 39 and 48, as set out in Article 4(3) EMIR.

[1] ESMA has acknowledged that EU clearing members of third country CCPs are not required to comply with the Article 39 segregation requirements when offering client clearing – see ESMA Q&A CCP Q8(j).

Without amendment to address the issues summarised above and discussed in more detail in our responses to Questions 9 and 10 of this response, we consider that the proposed RTS could pose significant legal, commercial and operational challenges for participants, and for indirect clients established in the EU and risk shutting such indirect clients out of global markets.

Preventing access to the global markets for indirect clients would reduce their ability to manage risk and damage liquidity in such financial markets. It is possible that the associated commercial pressures relating to the proposals in the draft RTS would also make indirect clearing arrangements within the EU prohibitively expensive and again reduce the ability for indirect clients to manage risk and damage liquidity in the financial markets.

We trust that our comments are useful and look forward to continued engagement with ESMA throughout the implementation of MiFID II and MiFIR.

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<ESMA_COMMENT_ RTS_ INDIRECT_CLEARING_1>

Questions from the consultation paper

Q1. Do you agree with the proposed approach to require the choice between an omnibus indirect account and a gross omnibus indirect account with margin at the level of the CCP?

<ESMA_QUESTION_RTS_INDIRECT_CLEARING_1>
[Under the draft RTS, the client must offer the indirect client a choice between the NOSA and GOSA in the records and accounts of the clearing member. Under the NOSA, separate records and accounts enable each client to distinguish in accounts with the clearing member the assets and positions of the client from those held for its indirect clients. Under the GOSA, this is the same as the NOSA but, in addition, the clearing member must distinguish in its accounts the positions and collateral value, after applying any haircut agreed between the counterparties, held for the account of each indirect client within the omnibus indirect client account.

These constitute new types of accounts that will need to be created and held at CCPs, together with associated obligations to calculate margin requirements for each indirect client in a GOSA, based on information provided by the clearing member.

While we acknowledge that CCPs are capable of building and operating these additional accounts, we do not consider that it is necessary for CCPs to be required to create two new types of account to make the indirect clearing model work. In addition, the requirement for each clearing member to open a separate NOSA / GOSA at the CCP for holding the assets and positions of the indirect clients of each client in the indirect clearing chain would give rise to an unnecessary and burdensome proliferation of accounts throughout the indirect clearing chain, and particularly at the CCP level. We explain these two issues in more detail in turn below:

<u>Requirement to offer GOSA and NOSA</u>

We agree with the decision to remove the requirement from the previous consultation that the CCP should offer individual client accounts for groups of indirect clients that share an omnibus account at clearing member level. We are also pleased that ESMA recognises that a GOSA more naturally lends itself to margining a group of clients in the same account on a per (indirect) client basis and that it also remains possible for individual client accounts to be offered.

In relation to the proposed GOSA model, we recommend that ESMA should provide additional detail or clarification around the nature and characteristics of the GOSA which we believe would be necessary in order for CCPs to develop the model. For example, is it proposed that the collateral value of one customer is at risk from losses on another client's positions at the point the account is liquidated? In gross omnibus segregated accounts the positions and collateral of customers are commingled and not segregated / protected from each other and this could lead to fellow customer risk. If the clearing member does not provide its collateral in respect of an indirect client one day and there is therefore a shortfall in the GOSA, who bears that loss? If there is any excess in the account, can that be used?

We also consider that the effect of the requirement to offer both GOSA and NOSA also adds to the operational complexity of the proposals and potential proliferation of accounts at all levels of the indirect clearing chain, considered in more detail below.

Proliferation of accounts throughout the indirect clearing chain

Based on our understanding of the draft RTS, it appears that (i) clearing members are required by Articles 3(1) and 5(4) MiFIR / Article 5(4) EMIR RTS to open a separate NOSA / GOSA (as appropriate) at the CCP for each direct client of the clearing member for the purposes of holding the indirect client assets and positions of the client separate from its own positions; and (ii) the result of the drafting in the RTS is that each level of the indirect clearing chain would need to implement a similar structure, resulting in a proliferation of accounts at each level of the clearing chain and at the CCP.

The requirement for the separate NOSA / GOSA at each level of the indirect clearing chain would require a significant increase in the required accounts and operational processes at each level, with associated additional costs and operational risk again at each level. It is clear that the requirement for CCPs to open a separate NOSA / OSA per client of the clearing member will lead to an unnecessary multiplication of accounts with attendant complexity, cost and operational risk at CCP level. The proliferation of accounts may reduce operational efficiency in terms of stress, such as the need for a CCP to take prompt actions on the default of a clearing member. While CCPs are able to build and offer such a model, we consider it would increase operational complexity and ongoing servicing costs without any tangible benefits in terms of indirect client protection. It also appears that such a model would not be consistent with the stated aim of the GOSA / NOSA model in the Consultation Paper which was to reduce the operational complexity of indirect clearing.

We continue to have reservations about the ability of the market to support the addition of further CCP account structures and there is also a question as to the need for the CCP to hold so many accounts at CCP level under a legislative proposal that does not anticipate the CCP will play any part in the default management of a defaulting client, as this is performed by the clearing member. With each EU authorised CCP already offering at least two models of segregation (and some two or three times that) we understand that there are currently in excess of 40 account structures on offer from the existing authorised CCPs. If each CCP is required to add an additional set of accounts to its offering there is a real risk that clearing members may not be able to offer all these segregation models to their clients.

Proposed alternative

We endorse an alternative model under which a clearing member would be required to open a single NOSA / GOSA at the CCP level for the purposes of holding assets and positions of all indirect clients, rather than opening accounts on a per client basis. This would reduce the number of accounts required and the operational complexity without, in our opinion, conflicting with the policy objective of separating the positions and collateral of the indirect client and the client, as set out in paragraph 28 of the Consultation Paper. This structure could be replicated at each level of the indirect clearing chain, i.e. a single GOSA / NOSA could be put in place for all indirect clients.

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<ESMA_QUESTION_RTS_INDIRECT_CLEARING_1>

Q2. Do you agree with the proposed approach for the requirements related to default management? Do you think there are alternative level 2 requirements (compatible with the relevant insolvency regime situations and the level 1 mandate) that would achieve better protections?

<ESMA_QUESTION_RTS_INDIRECT_CLEARING_2>
[The obligations under the default management requirements fall primarily on clearing members and clients rather than on CCPs. While it is clear from the Consultation Paper that ESMA recognises the potential for conflicts of law between the RTS requirements and relevant local insolvency regimes (i.e. those affecting a clearing member or client) and also the limitations on the EU legal framework in its ability to override a third country insolvency regime, the imposition of the porting obligation in the MiFIR RTS (albeit an "obligation of means" rather than outcome) appears to be unlikely, impracticable and also a source of considerable legal uncertainty and potential expense for clearing members and clients to consider.

Given the liquid nature of ETD markets, it seems more practicable that positions of an indirect client could be closed out and reopened with another client in the event of the default of an existing client, which is likely to achieve many of the practical benefits of porting without the associated time delays and legal and practical problems, all of which are acknowledged by ESMA in the Consultation Paper.

From the clearing member's perspective, it will need to be able to rely on a legal right to port or return liquidation proceeds to the indirect client, i.e. "leapfrog payments". Unless Member State legislation is developed to clearly permit this, clearing members will have to resort to legal structures such as assignments to achieve this. While not necessarily legally complex in their own right, the effectiveness of such structures needs to be checked for feasibility in each location of client and indirect client and adapted accordingly, which makes them expensive and complicated, especially if they have to be put in place for different CCPs and combinations of clearing member / client jurisdictions. Where there are participants in jurisdictions outside the EU, the complexity of such arrangements may have additional issues arising from conflicts of laws. Above all, it appears to be unclear as to the extent to which an "obligation of means" is capable of being shown to have been suitably honoured by a clearing member.

From a CCP perspective, we consider that additional clarification is required in relation to the requirements applicable to CCPs holding the assets relating to the indirect clients' positions and to confirm that it takes instructions from the clearing member, as its contractual counterparty. We suggest that it should be recognised that the CCP will return assets to the clearing member on a client default. For example, we assume that, in the event of a joint default of the clearing member and client, the requirement to port under Article 48 EMIR will not apply to these accounts and we would suggest that the CCP should still only be required to return the balance relating to each indirect client to the clearing member or client, as suggested by Article 48(7) EMIR. We assume that it is not intended that CCPs would also need to put in place a legal mechanism to enable them to

return assets directly to the indirect client (by way of an extended "leapfrog payment")[2] but we kindly request that this be clarified.

On the client side, where it is not feasible for liquidation proceeds on a client default to be returned directly to the indirect client, Article 5(8) requires such proceeds to be returned instead to the client under the "necessary arrangements in place to ensure that any liquidation proceeds received by the client for the account of one or more indirect clients does not form part of the client's insolvency estate". Again, the RTS does not propose legislation to assist in this regard but instead places the burden on the industry to put in place a solution which will require legal analysis and appropriate standardised contractual documentation to be put in place on a jurisdiction by jurisdiction basis, depending on the domicile of the relevant entities in the clearing chain.

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<ESMA_QUESTION_RTS_INDIRECT_CLEARING_2>

Q3. Do you agree that the proposed approach adequately addresses counterparty risk throughout the longer chain by ensuring an appropriate level of protection to indirect clients? If not, are there alternative approaches compatible with Level 1?

<ESMA_QUESTION_RTS_INDIRECT_CLEARING_3>
[We agree with ESMA's statement that indirect clearing solutions for OTC derivatives are still being developed, meaning that this question is relevant only to ETD in the current environment. While ESMA recognises that longer chains do already exist in the ETD market, we consider that the aim of delivering a level of protection of "equivalent effect" all the way down the longer chain to the ultimate indirect client at the end of the chain is likely to pose a considerable challenge which existing chains in the ETD market may not be able to overcome.

As a starting point, in longer chains it is not clear to what extent obligations and rights / protections attached to the "indirect client" within the RTS refer to the client at the end of the chain or the intermediary or intermediaries between such "indirect client" and the clearing member. As drafted, this uncertainty renders it unlikely that participants will be able to put in place effective structures. Moreover, as chains lengthen the number of accounts required in order to be held at each level in the chain (and ultimately at the CCP) increases exponentially, together with practical and operational difficulties in meeting the information flow requirements suggested (but which should be clarified) in the RTS. In addition, as chains lengthen, the likelihood of one or more intermediaries being a non-EU entity also increases, thereby also increasing legal complexity given the potential interaction between legal regimes that may give rise to conflicts of law.

Above all, it should be clarified that the primary contractual arrangements of a CCP are with its clearing members and do not extend down through the longer chain[3]. On a related note, we believe that it would be helpful for the MiFIR RTS to clarify the point at which an indirect client in a long ETD

[2] CCPs would need to receive sufficient information about the indirect clients to enable them to do so. This would add an extra layer of complexity to the arrangements.
[3] ESMA should also clarify that CCPs do not necessarily know the identities of indirect clients and therefore are not required to perform AML/KYC checks on such indirect clients.

clearing chain is no longer deemed to be contracting in relation to a cleared ETD contract and is instead entering into an OTC derivative.

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<ESMA_QUESTION_RTS_INDIRECT_CLEARING_3>

Q4. For longer chains, what other details (liquidation trigger and steps, flow and content of information, other) should be taken into account or what additional requirements or clarification should be provided in order to avoid potential difficulties when handling the default of a client or an indirect client facilitating clearing services?

<ESMA_QUESTION_RTS_INDIRECT_CLEARING_4>
[We have no comments.]
<ESMA_QUESTION_RTS_INDIRECT_CLEARING_4>

Q5. Do you consider that the new provision assigning by default to the indirect client the choice of an omnibus indirect account following reasonable efforts from the client to receive an instruction is appropriate? If not, what other considerations should be taken into account?

<ESMA_QUESTION_RTS_INDIRECT_CLEARING_5>
[We have no comments.]
<ESMA_QUESTION_RTS_INDIRECT_CLEARING_5>

Q6. Do you consider appropriate that the collateral provided on top of the amount of margin the indirect client is called for is treated in accordance with the contractual arrangements?

<ESMA_QUESTION_RTS_INDIRECT_CLEARING_6>
[Under the GOSA model, it is proposed under Article 4(4) of the RTS that a clearing member shall transfer to the CCP the collateral value, after applying any haircut as agreed between the counterparties, it receives from its client for the account of each indirect client, which does not include any additional collateral received above the margin amount called by the clearing member. The current drafting and formulation seems a little unclear and ESMA should attempt to clarify the meaning of this provision.

It would be helpful if ESMA could also clarify that CCPs are not be expected to allocate excess collateral received in relation to the account of an individual indirect client in a GOSA. We request that ESMA should confirm that CCPs should not be required to offer a GOSA with excess type model, as this would only increase operational complexity and costs for all in the indirect clearing chain.
]
<ESMA_QUESTION_RTS_INDIRECT_CLEARING_6>

Q7. In view of the different amendments described above, do you consider that this set of requirements ensures a level of protection with equivalent effect as referred to in Articles 39 and 48 of EMIR for indirect clients?

<ESMA_QUESTION_RTS_INDIRECT_CLEARING_7>
[While this is not a question of direct application to CCPs, it is clear that the requirements for default management raise considerable potential difficulties for the clearing member and client community. We refer to the responses submitted by FIA Europe and ISDA on this issue.]
<ESMA_QUESTION_RTS_INDIRECT_CLEARING_7>

Q8. Please indicate your answers to the cost-benefit survey?

<ESMA_QUESTION_RTS_INDIRECT_CLEARING_8>
[As set out in our response to Q1, we consider that the requirement for CCPs to open a separate NOSA / GOSA at each level of the indirect clearing chain would require a significant increase in the number of required accounts and complexity of operational processes at each level of the indirect clearing chain, with associated additional costs and operational risk again at each level.

From a CCP perspective, the requirement for CCPs to open a separate NOSA / OSA per client of the clearing member will lead to an unnecessary multiplication of accounts with attendant complexity, cost and operational risk. While we estimate that the initial build cost would be likely to be in the same region regardless of whether the CCP has to design and build (i) a NOSA / GOSA per client per clearing member or (ii) a single NOSA / GOSA per clearing member, we estimate that the ongoing operational and servicing costs of the first model would be significantly more without any tangible additional benefits in terms of indirect client protection. The incremental costs associated with multiple accounts under model (i) would add direct additional costs to CCPs to maintain and service the accounts, in particular, additional staffing and resource costs required for overseeing, operating and servicing what we anticipate to be a significant number of new accounts.

This increased cost will ultimately be passed down the chain to the indirect client in a way that does not provide value for client risk management. We consider that this is likely to make indirect clearing more expensive than under model (ii), which in turn may disincentivise indirect client clearing or the access of indirect clients to certain markets.

<ESMA_QUESTION_RTS_INDIRECT_CLEARING_8>

Q9. Do you have any comments on the draft RTS under EMIR not already covered in the previous questions?

<ESMA_QUESTION_RTS_INDIRECT_CLEARING_9>
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Application to third country CCPs

ESMA's proposed RTS relating to the indirect clearing obligation under EMIR sets out the requirements for indirect clearing arrangements with regard to "OTC derivative contracts" within the meaning of EMIR[4].

We are concerned that the effect of the proposed drafting of the EMIR RTS is such that indirect clients are prevented from using EMIR recognised third country CCPs in order to satisfy the clearing obligation in relation to OTC derivatives, either because the CCP itself is not able to provide the specific protections required by the EMIR RTS or firms in the clearing chain required to provide access to the CCP are not able to provide such protections, i.e. because they are subject to incompatible local laws or regulatory requirements.

This appears to contradict the position taken by ESMA in the EMIR Q&A CCP Q8(j) which acknowledged that EU clearing members of third country CCPs are not required to comply with the Article 39 segregation requirements when offering client clearing and that third country CCPs must provide client clearing services in accordance with applicable local requirements. Under the client clearing regime it is sufficient that the relevant third country CCP is a recognised CCP under Article 25 of EMIR, which process includes an assessment of applicable client protections, including segregation, and on that basis the recognised CCP is deemed to provide an equivalent degree of protection.

It follows that indirect clearing should operate in the same manner, such that the third country CCP recognition process must be considered as demonstrating that the CCP and associated chain provides protection with equivalent effect to that referred to in Articles 39 and 48, as set out in Article 4(3) of EMIR. As a result, it should not be necessary for the indirect clearing chain to meet the requirements of the EMIR RTS where there is an EMIR recognised CCP at one end of the indirect clearing chain.

In relation to intermediaries within the indirect clearing chain, ESMA should again follow the principles behind the approach adopted in the ESMA CCP Q&A which provides a practical solution. Where, for example, an indirect clearing arrangement containing a third country entity is unable to provide the same levels of protection as required by the draft RTS, this fact should be fully disclosed to the client or indirect client but the arrangement is not prohibited. On the basis that the relevant client or indirect client is fully aware of the potential risks but nevertheless determines it is prepared to proceed on this basis then the arrangement should be "permissible". We consider that such an approach would be in line with the existing ESMA guidance in the EMIR Q&A. If such an approach is not adopted, it appears likely that a significant proportion of the indirect clearing chains connecting to third country CCPs would not be permissible. Preventing access to third country CCPs for indirect clients would reduce the ability of these indirect clients to manage risk and would damage liquidity in the global financial markets.

[4] In the case of ETDs traded on a third country venue, such derivatives are currently treated as OTC under EMIR. It is anticipated that this issue will be addressed under the new Article 2a of EMIR which will provide a mechanism for third country markets to be recognised as equivalent for the purposes of EMIR, meaning that they would no longer be treated as "OTC derivatives". Note that it is not until the relevant third country market is considered to be equivalent to a regulated market pursuant to the MiFIR trading obligation (Article 28(4) MiFIR) that the relevant instruments will be treated as "exchange traded derivatives" for the purposes of MiFIR, at which point ESMA's proposed MiFIR RTS would apply.

Requirement on CCPs to manage risk

We note that CCPs are required under both the EMIR and MiFIR RTS to "identify, monitor and manage any material risks arising from indirect clearing arrangements that could affect the resilience of the CCP" (see, for example, MiFIR RTS Article 3(3)). ESMA should provide clarification on the expectations on CCPs in practice given that the CCP will have little control over indirect clients and will not necessarily know the identity of such indirect clients on the basis there is no direct contractual nexus.

We propose that ESMA should acknowledge that the CCP is subject to such limitations to this end depending on the information received by the CCP from the clearing member in any indirect clearing chain, and the clearing member is in turn dependent on the information received from its own clients in relation to the underlying indirect clients.

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<ESMA_QUESTION_RTS_INDIRECT_CLEARING_9>

Q10. Do you have any comments on the draft RTS under MiFIR not already covered in the previous questions?

<ESMA_QUESTION_RTS_INDIRECT_CLEARING_10>
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We are particularly concerned by ESMA's proposals in relation to ETDs traded on third country markets and cleared by third country CCPs. We recommend that the application of the draft RTS should be limited to indirect clearing chains that relate to transactions that take place on EU regulated markets and are cleared through EU CCPs. Furthermore, the requirements should be drafted in a manner that does not result in significant disruption to established market access models or otherwise operate in a manner that prevents indirect clients established in the EU from accessing the global financial markets to meet their risk management needs.

Application to third country trading venues and CCPs

The draft RTS set out the requirements for indirect clearing arrangements with regard to "exchange traded derivatives" within the meaning of MiFIR. An "exchange traded derivative" for these purposes is one which is traded on a regulated market or a market which is considered to be equivalent for the purposes of the trading obligation under MiFIR. In the case of ETDs traded on a third country market specifically, such derivatives are currently treated as OTC under the EU regulatory framework. From the point that the relevant market is considered to be equivalent to a regulated market pursuant to Article 28(4) of MiFIR, the relevant instruments will be treated as "exchange traded derivatives" for the purposes of MiFIR, at which point the draft RTS would apply.

Where that market is cleared by a third country CCP then the local insolvency law or regulatory framework may prevent the relevant clearing member from opening at the CCP the separate accounts prescribed by the draft RTS for each client and the indirect clients of each client. In

addition, the local insolvency law or regulatory framework may prevent an FCM in certain circumstances from being able to transfer the positions and assets in a GOSA indirect client account to another client on a client default or to liquidate the assets and return the balance to the relevant indirect clients.

Given that the Article 28(4) process involves a determination that the third country framework is of equivalent standard as that for EU regulated markets, it follows that any market determined to be equivalent pursuant to Article 28(4) should not additionally be held to a line-by-line equivalence standard in respect of the insolvency law framework or account structure regulations which would be the effect of ESMA's proposed RTS.

We are concerned that the effect of the proposed drafting of the EMIR RTS is such that indirect clients are prevented from using EMIR recognised third country CCPs, either because the CCP itself is not able to provide the specific protections required by the EMIR RTS or firms in the clearing chain required to provide access to the CCP are not able to provide such protections.

This appears to contradict the position taken by ESMA in the EMIR Q&A CCP Q8(j) which acknowledged that EU clearing members of third country CCPs are not required to comply with the Article 39 segregation requirements when offering client clearing and that third country CCPs must provide client clearing services in accordance with applicable local requirements. Under the client clearing regime it is sufficient that the relevant third country CCP is a recognised CCP under Article 25 of EMIR, which process includes an assessment of applicable client protections, including segregation, and on that basis the recognised CCP is deemed to provide an equivalent degree of protection.

Application to clearing members and clients

ESMA acknowledges that any given indirect clearing structure may contain third country entities, for example a clearing member or client. These entities may be subject to conflicting local legal or regulatory requirements and therefore unable to comply with the requirements in the draft RTS. While ESMA acknowledges this issue and recognises that it is likely that the draft RTS are not able to override conflicting local insolvency law, it is not clear whether in such a situation ESMA would consider an indirect clearing chain containing such an entity to be "permissible" for the purposes of MiFIR Article 30(1). If such arrangements are not permissible for these purposes, then a significant number of existing clearing arrangements for trading ETDs would likely not be permitted to continue. As a result, ESMA's proposed RTS may have the effect of preventing indirect clients established in the EU from participating in markets outside of the EU, reducing their ability to manage risk and damaging liquidity in such financial markets.

By way of practical solution, we suggest that in a situation where, for example, an indirect clearing arrangement containing a third country entity is unable to provide the same levels of protection as required by the draft RTS, this fact should be fully disclosed to the client or indirect client but the arrangement is not otherwise prohibited. On the basis that the relevant client or indirect client is fully aware of the potential risks but nevertheless determines it is prepared to proceed on this basis then

the arrangement should be “permissible”. We consider that such an approach would be in line with the existing ESMA guidance in the EMIR Q&A.

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