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| 1 October 2014|ESMA/2014/1185 Reply Form |

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| Reply form for the Consultation Paper  On the Clearing Obligation under EMIR (no. 3) |

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| Date: 1 October 2014  ESMA/2014/1185 Reply Form |

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA Consultation Paper - Clearing Obligation under EMIR (no. 3), published on the ESMA website.

Responses are most helpful:

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

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

Responses must reach us by **6 November 2014**.

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input/Consultations’.

Instructions

Please note that, in order to facilitate the analysis of the responses, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, please follow the instructions described below:

1. use this form and send your responses in Word format;
2. do not remove the tags of type < ESMA\_CA3\_QUESTION\_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
3. 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.

Publication of responses

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that 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 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](http://www.esma.europa.eu) under the heading ‘Disclaimer’.

# General information about respondent

|  |  |
| --- | --- |
| Are you representing an association? | Yes |
| Activity: | Investment Services |
| Country/Region | Germany |

# Introduction

**Please make your introductory comments below:**

<ESMA\_CO3\_COMMENT\_1>

BVI1 gladly takes the opportunity to present its views on the Consultation Paper on the clearing obligation under EMIR. In Germany, regulated investment funds (UCITS/AIF) generally use Non-Deliverable Forwards (NDFs) to hedge the currency risk in an investment portfolio.

In addition to our answers to the questions below we also support the response of the Investment Management Association (IMA).

We would like to make the following comments:

1 BVI represents the interests of the German investment fund and asset management industry. Its 83 members manage assets in excess of EUR 2.2 trillion in retail funds, Spezialfonds and assets outside investment funds. As such, BVI is committed to improving the overall conditions for investors, while at the same time promoting a level playing field for all investors across all financial markets. BVI members manage, directly or indirectly, the assets of 50 million private clients over 21 million households. (BVI’s ID number in the EU Transparency Register is 96816064173-47). For more information, please visit www.bvi.de.

<ESMA\_CO3\_COMMENT\_1>

## The clearing obligation procedure

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

<ESMA\_CO3\_QUESTION\_1>

We agree with ESMA`s proposal to group, to the extent possible, the analysis of the notified classes of OTC derivatives in a minimal set of Consultation Papers.

As mentioned in our previous positions on the clearing obligation under EMIR, it is crucial that Central Counterparties authorized by the National Competent Authority (NCA) have to offer at least one segregation model which allows all market participants (e.g. UCITS/AIF) to clear OTC products without breaching European investment fund law (please see our answer to question 3).

<ESMA\_CO3\_QUESTION\_1>

## Structure of the non-deliverable forward derivatives classes

##### Do you consider that the proposed structure for the FX NDF classes enables counterparties to identify which contracts are subject to the clearing obligation?

<ESMA\_CO3\_QUESTION\_2>

We support the approach to classify NDFs as proposed in the Consultation Paper. We agree with ESMA`s assessment that a distinction between cash settled and physically settled FX contracts is key, as the two categories of products expose the CCPs to completely different types of risks. The proposed characteristics of the NDFs should also take into consideration EUR as a settlement currency as regulated investment funds (UCITS/AIF) very often use this currency as the underlying fund currency.

However, mandating the clearing obligation for NDFs at this time is questionable due to the nature, complexity and market structure of the Non-Deliverable Forwards. Furthermore, the establishment of new client clearing arrangements to the CM and the CCPs is a complex task, binding many resources and taking time (please see our answers to question 3 and 5).

<ESMA\_CO3\_QUESTION\_2>

## Determination of the classes of OTC derivatives to be subject to the clearing obligation

##### In view of the criteria set in Article 5(4) of EMIR, do you consider that the determination of this class addresses appropriately the objective of reduction of the systemic risk associated to NDF derivatives?

<ESMA\_CO3\_QUESTION\_3>

We do not support ESMA`s assessment to mandate a clearing obligation only for part of NDF derivatives (here: settlement currency USD) as it is not reasonable to assume in this case a correlation between the before mentioned clearing requirement and the reduction of systemic risk.

We are of the view that the cost of implementation of a clearing obligation only for part of NDFs for the German fund management companies is disproportionate to the reduction of systemic risk in the FX market. NDFs represent only a small portion of the global FX market. NDFs are subject to stringent bilateral requirements (e.g. margin requirement, EMIR reporting, reconciliation etc). Furthermore, we expect that a potential clearing obligation for NDFs will not contribute to a significant reduction of systemic risk as foreseen for the IRS and CDS market.

The currency pairs of the NDFs evolve over time meaning that new currencies will be classified as non-deliverable forwards (e.g. in Africa) whereby others might lose their relevance in the market. The classification of a currency pair as NDFs is mainly driven by the regulatory framework and monetary decision of the respective (emerging-market) countries (please see para. 51). This could lead to unintended consequences whereby in some cases NDFs may not be available anymore for clearing during the onboarding process to a CCP. Given that fact, the determination of the clearing obligation of a NDF class cannot be used as an objective to reduce systemic risk in the FX market. Pursuant to EMIR, since 12 February 2014 financial counterparties (e.g. UCITS/AIF) have to report (OTC) derivative contracts to Trade Repositories (TR). ESMA and the National Competent Authorities should have all relevant information in order to assess if the NDF market as whole poses a systemic risk.

As the NDF market is global in nature, we expect that all regulators worldwide align their plans for a possible clearing mandate for NDFs. We know that the CFTC discusses with Europe whether a clearing mandate is appropriate for NDFs. Only a global solution will provide a level playing field for all market participants.

<ESMA\_CO3\_QUESTION\_3>

##### For the currency pairs proposed for the clearing obligation on the NDF class, do you consider there are risks to include longer maturities, up to the 2 year tenor?

<ESMA\_CO3\_QUESTION\_4>

We do not agree with the approach to consider a clearing mandate for NDFs with a maturity exceeding two years. Most of the NDF contracts have a tenor of less than six month with sufficient liquidity. NDFs with a tenor of up to two years have insufficient liquidity and are therefore not fit for clearing.

<ESMA\_CO3\_QUESTION\_4>

## Determination of the dates on which the obligation applies and the categories of counterparties

##### Do you have any comment on the analysis presented in Section 4.1?

<ESMA\_CO3\_QUESTION\_5>

The introduction of a NDF clearing obligation should be carefully calibrated and not be rushed. At this stage, it seems very challenging to us to mandate a clearing obligation for NDFs analogous to the clearing implementation timeline as foreseen for IRSs and CDSs due to the following reasons:

* **Restricted market structure of CCPs and Clearing Members offering client clearing**

We agree with ESMA`s assessment that the market structure of CCPs and CMs offering client clearing for NDFs is very restricted (para. 95 and 100). However, we do not share ESMA´s assumptions that over time new CCPs and CMs will develop new client clearing arrangements which would be consistent with the proposed timelines as foreseen for IRSs and CDSs (para. 101). Furthermore, we do not support ESMA´s view that the client clearing arrangements for IRSs/CDSs currently offered by CCPs and CMs to the buy-side could be used as examples to assume that similar conditions for NDFs could evolve over time with the same pace which is in line with the proposed starting date for the clearing obligation.

The experiences currently made by the German management companies illustrate that the implementation of client clearing arrangements provided both on the level of the CCPs and of the clearing members is a complex task, binding many resources and taking time. The CDS client clearing offerings provided both on the level of the CCPs and of the clearing members is not sufficiently broad enough in comparison to the infrastructure of the interest rate derivative market. We fear that the limited client clearing offerings could cause bottleneck situations as all clients (UCITS/AIF) need to set up legal and operational arrangements with the CCPs and the clearing members at the same time.

As the NDF clearing started in Europe with only one CCP in 2012 and as the client clearing arrangements both on the level of the CCP and of the clearing members are far less developed in comparison to the interest rate derivative market, we strongly fear that the implementation of the client clearing arrangements for the German management companies are practically impossible according to the proposed starting date for the clearing obligation.

In this context, we would like to reiterate our positions, already submitted to ESMA in previous consultations, that the obligation to segregate the positions of each investment fund (Article 8 para. 1 of Directive 2010/43/EC) should be incorporated in the segregation models offered by the CCPs and the CMs. The terms “individual client segregation” and “omnibus client segregation” are not clearly defined with the consequence that each CCP develops, interprets and offers its own segregation model to the financial industry. Until now, neither ESMA nor the NCAs have clarified which CCP segregation models are in line with Article 8 para. 1 of Directive 2010/43/EC. In this context, it needs to be clarified how omnibus segregation models offered by non-EU CCPs should be treated under the European investment fund law. We thus think that ESMA should provide Guidelines whether the segregation models offered by the relevant CCPs are in compliance with the European investment fund law requirements on segregation of assets of contractual investment funds. Until now, we have not seen any NDF client clearing offerings which provide information on the segregation models which are in line with the European investment fund law. In this respect, the German management companies also need legal certainty.

CCPs and clearing members offering client clearing arrangements should be capable to establish and set up the new clearing links to the management companies over time. The buy-side has to rely on the willingness and the capability of the clearing members and the CCPs to set up the clearing arrangements in time, particularly in cases where only one CCP or a small number of clearing members offer client clearing models.

Due to the publication of the Consultation Paper, the NDF clearing discussion has now started to become more important between financial counterparties (e.g. UCITS/AIF). The extensive debate and the experiences of the clearing obligation related to IRS/CDS made by the German management companies developed over the last years. The determination of an NDF clearing obligation for a class of derivative which is relatively new is totally different from the clearing requirements for IRS where both the CCP and financial counterparties (e.g. UCITS/AIF) have developed a market infrastructure based on long time experience and knowledge. Thus, market participants have to analyze the new evolving market clearing infrastructure in depth in order to assess if these arrangements are fit for a possible clearing obligation.

Therefore, we strongly urge ESMA to consider a NDF clearing obligation only if sufficient CCPs and clearing members are able to provide clearing service incorporating segregation model offerings which are compliant with the European investment fund law. Based on the knowledge of this market infrastructure offerings, ESMA should develop technical standards specifying the phase-in approach for

the different categories for the financial counterparties.

* **Fund-related specifics of the clearing arrangements with the Clearing Member/CCPs**

The conclusion of (new) legal arrangements between the management company and the counterparty (e.g. a credit institution) involves the incorporation of additional fund related legal aspects which go beyond the standard normal master agreements.

A CCP rulebook may contain specific provisions which require modifications to the industry standard documentation between the fund manager and the CM in order to avoid a potential shortfall in the case of a default of a CM. If the management company agrees to such modifications of the clearing arrangements with their CM, it might eliminate potential counterparty risk of the clearing member. Until now, no German management company has verified the relevant CCP rulebook to fund related specifics.

<ESMA\_CO3\_QUESTION\_5>

##### Do you agree with the proposal to keep the same definition of the categories of counterparties for the NDF classes than for the credit and the interest rate classes? Please explain why and possible alternatives.

<ESMA\_CO3\_QUESTION\_6>

We agree in general to keep the same definition of the categories of counterparties as proposed by ESMA in the Final Report for IRS sent on 1 October 2014 to the EU Commission (ESMA/2014/1184). However, a clarification of Category 2 is necessary in respect to the definition of financial counterparties (e.g. UCITS/AIF) which belong to a group.

The above mentioned Final Report for IRS does not include a clear provision related to the incorporation of regulated investment funds (UCITS/AIF) in the calculation of the threshold of the group´s notional amount of non-centrally cleared derivatives. In this context, we recommend to incorporate in the definition of the Category 2 the same approach for investment funds as proposed in Recital 5 of the EBA Consultation Paper (JC/CP/2014/03). This means, that as soon as the threshold applies at group level, for regulated investment funds this should be counted per single fund. This is consistent with international standards where investment funds that are managed by an investment advisor should be considered distinct entities and treated separately when applying the threshold. The proposed provision will ensure that all financial counterparties have the same understanding of the treatment of investment funds in the calculation of the group`s threshold, thus enhancing legal certainty for all market participants.

<ESMA\_CO3\_QUESTION\_6>

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

<ESMA\_CO3\_QUESTION\_7>

Please see our answer to question 5. ESMA states in para. 100 that currently only 2 clearing members of LCH.Clearnet Ltd offer client clearing. Given the restricted NDF market structure of client clearing offerings and the experience made by German management companies in relation to set up IRS/CDS clearing arrangements, we do not agree with ESMA`s view to use the same phase-in approach for the NDF clearing obligation as foreseen for IRS and CDS.

At this stage, it seems impossible to us to propose a timeline for the NDF clearing obligation as we do not know how the market infrastructure for NDF client clearing offerings will evolve over time. Therefore, as mentioned above, ESMA should develop only technical standards with a timeline for the NDF clearing obligation if sufficient CCPs and clearing members are able to provide client clearing service to the buy-side.

Furthermore, ESMA needs to ensure that the timeline for the NDF clearing obligation is aligned with other jurisdictions, particularly with the US and Asia. As the NDF market is global in nature, market participants could opt to use a market where the financial counterparties are not subject to a clearing obligation, thereby avoiding the cost of implementation to set up client clearing arrangements with the CCPs and the CMs.

<ESMA\_CO3\_QUESTION\_7>

## Remaining maturity and frontloading

##### Do you have comments on the minimum remaining maturities for NDF?

<ESMA\_CO3\_QUESTION\_8>

We agree with ESMA`s proposal. However, ESMA should develop a balanced approach considering an efficient phase-in approach for Category 3 (UCITS/AIF) and a reasonable implementation time for the frontloading requirement. Furthermore, we would expect that contracts concluded and terminated between on or after the publication in the Official Journal of the RTS and the date on which the clearing obligation takes effect (the date of application) do not need to be frontloaded in a CCP due to that fact they do not create any counterparty or systemic risk.

<ESMA\_CO3\_QUESTION\_8>

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

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

<ESMA\_CO3\_QUESTION\_9>

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<ESMA\_CO3\_QUESTION\_9>

# Annex III – Impact assessment

##### Please indicate your comments on the Impact Assessment.

<ESMA\_CO3\_QUESTION\_10>

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<ESMA\_CO3\_QUESTION\_10>