FK | Finanssialan Keskusliitto
FC | Finansbranschens Centralförbund
FFI | Federation of Finnish Financial Services

10.7.2015

Kirvelä Elina

The Federation of Finnish Financial Services (FFI) represents the interests of banks, insurers, finance houses, securities dealers, fund management companies and financial employers. Its members also include providers of statutory insurance lines, which account for much of Finnish social security.

Joint Committee of the European Supervisory Authorities

JC/CP/2015/002]

FFI RESPONSE TO THE SECOND CONSULTATION PAPER ON DRAFT REGULATORY TECHNICAL STANDARDS ON RISK-MITIGATION TECHNIQUES FOR OTC-DERIVATIVE CONTRACTS NOT CLEARED BY A CCP UNDERARTICLE 11(15) OF REGULATION (EU) NO 648/2012

Federation of Finnish Financial Services (hereinafter FFI) welcomes the consultation on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP. We would like to express following comments on this important topic.

KEY POINTS

- FFI welcomes the amended draft rules in general with a couple of exceptions. The alignment with international rules is highly appreciated as well as the existence of proportionality principle in many standards.

- We especially support the proposed phase-in structure which gives the market participant sufficient flexibility in terms of preparation and in proportion to their significance from a systemic risk perspective.

- We further welcome the fact that the revised draft RTS no longer require the entering into formal agreements with all counterparties regardless of their counterparty qualification, in order to be able to rely on existing exemptions from collecting and exchanging variation and initial margin. The elimination of this opt-out rule is crucial in limiting the burden these RTS place on market participants.

- One of our key issues during the first consultation in 2014 was the heavy legal and operational burden that would arise from the reviews of several contracts and processes. We are pleased to see that the interval for many reviews and tests seems to be mostly once in a year which is a significant operational ease. However the requirement for independent legal review in two articles should be further clarified to limit the unintended costs.

- Additional clarity would be beneficial also in terms of margin models. Additional clarity in the final RTS would better support the principles of better regulation that providing for the clarity later in additional Questions and Answers documents.

- Granting of intragroup exemptions is extremely vital to many Finnish market participants and especially to co-operative and other banks with a large number of intragroup transactions. The current text is a significant improvement from the previous version where in principle existence of any insolvency law would have fulfilled the definition of legal impediment. Yet we think that articles 2-4 IGT might still be too vague to ensure that the criteria for granting exemptions are applied consistently across the

member states.

- In terms of intragroup exemption, it could be added that an exemption has been granted to a group or institutional protection scheme based on either article 10 or article 113 (6) and (7) in the Regulation 575/2013 ("CRR") these structures should automatically benefit from the relevant intra-group exemptions of EMIR regulation. This would ensure legal certainty and simplify the procedures for competent authorities.

- We also note in this context that similar issues arise under Article 8.1(d) of CRR and in relation to that provision the Commission has issued a report ("Legal Obstacles to the Free Movement of Funds between Institutions within a Single Liquidity Sub-Group") addressing certain more specific potential legal obstacles and their relevance under Article 8 of CRR. We consider that similar guidance will be required in relation to Article 11(5) to (10) of EMIR.

- Finally, as a procedural remark, the consultation period for such an important topic should be much longer. Even though this is a second consultation, one month is simply not enough to assess the workability of these rules. The situation is even worse due to the fact that this consultation ran during summer time.

RESPONSES TO DETAILED QUESTIONS

Question 1. Respondents are invited to comment on the proposal in this section concerning the treatment of non-financial counterparties domiciled outside the EU.

No comments.

Question 2. Respondents are invited to comment on the proposal in this section concerning the timing of calculation, call and delivery of initial and variation margins.

FFI understands the ESAs request for daily exchange of margin. However the requirement on T+1 is very difficult to implement when counterparties are to complete the collection of margin within this timeframe. Therefore we would like to see an amendment in the rules that the initial margin shall be calculated within one business day and collected within the second business day following the events in art 1 EIM paragraph 3.

This amendment would mean that these requirements are operationally feasible. In the future as systems evolve and adjust to the new framework as a whole we assume that the exchange cycles will shorten. As the current timeline already enables a sound management of operational risk we would recommend avoiding too tight rules. This slight extension of the time-line would greatly reduce operational burden and associated operational risks.

Further the rules on margin calculation, call and collection create an unintended disadvantage for smaller counterparties. The distinction between initial and variation margin settlement timelines means that the smallest participants need to implement the above mentioned very tight processes quickly. The reality of settlement timelines could also force these small participants to use cash only as variation margin and therefore increase the costs and operational issues for the participants. Increased cash margins will reduce the cash available for investments and hence do not for example support the principles of capital markets union.

FK | Finanssialan Keskusliitto
FC | Finansbranschens Centralförbund
FFI | Federation of Finnish Financial Services

Kirvelä Elina

The text on article 1 EIM paragraph 2 is very unclear in terms of what the counterparties shall agree. We would welcome further clarity and linguistic check to ensure that any margin disputes caused by different interpretations of this article are avoided.

Question 3. Respondent are invited to provide comments on whether the draft RTS might produce unintended consequence concerning the design or the implementation of initial margin models.

It should be possible to choose between either an approach based on assigning a derivative contract to an underlying risk class based on its primary risk factor or to calculate all risk factors (interest rate, equity, etc.) for all trades and arrive at aggregate numbers for these risk factors. The latter approach would, for example, ensure that the interest rate risk is still calculated and included for trades where, for example, equity maybe the primary risk factor.

Question 4. Respondents are invited to comment on whether the requirements of this section concerning the concentration limits address the concerns expressed on the previous proposal.

Concentration limits should be defined in a way that it only defines limits to ensure that the value of and ability to liquidate the collateral is secured in the event of a counterparty default. With this in mind we do not see that restricting equities to 40% of posted IM is reflective of the liquidity characteristics of equities, especially since the criteria further restricts eligible equities to only those from the main indices. We would note that even during the financial crisis good levels of liquidity was maintained in the equity markets. We would therefore suggest that the concentration limit (40%) should be significantly higher and possibly removed.

In addition, the treatment of Nordic covered/mortgage bonds seems unnecessarily restrictive and in our view does not reflect the treatment of covered bonds under other EU regulation where they are considered high quality liquid asset, practically in-line with government bonds. We would refer specifically to studies performed by the EBA in the context of the eligibility of such asset within banks liquidity buffers, for LCR.

Another point of note is that for some jurisdictions there is a potential shortfall of eligible government bonds. In Denmark the size of the in covered bond market is greater than the size of the government bond market, elevating the significance of and therefore the need for similar treatment of covered bonds (under EMIR), given their (observed) similar quality and liquidity characteristics to government bonds.

One potential consequence of an overly tight treatment (e.g. the maximum contribution from any one issuer set to 10% of the total collateral value), combined with a shortage of other equivalent assets, could lead to (other) lower quality and less liquid assets being posted as collateral, i.e. an overall collateral “downgrade” which in turn increases risks for counterparties.

We would therefore propose that under this RTS Nordic covered / mortgage bonds receive similar treatment as government bonds, i.e. to have no concentration limits or that the maximum concentration limit is raised considerably.

Question 5. Respondent to this consultation are invited to highlight their concerns on the requirements on trading relationship documentation.

We greatly appreciate that the revised draft RTS no longer require the entering into formal agreements with all counterparties regardless of their counterparty qualification, in order to be able to rely on existing exemptions from collecting and exchanging variation and initial margin. The elimination of this opt-out rule is crucial in limiting the burden these RTS place on market participants.

However, a clear distinction still has to be drawn between the general contractual framework which has to be in place in advance of or at the time of the conclusion of the transaction and the trade confirmation which may cover additional terms but may only be formally documented following the agreement on a transaction. Therefore the requirement should be fine-tuned to apply only to the information that is available prior to the transaction and to clarify that it does not apply to information such as payment obligations which cannot be documented before conclusion.

The requirement for independent legal review of bilateral netting arrangements in article 2 OPD paragraph 2 would also benefit from further clarity. This is an understandable requirement that ESAs have proposed to be implemented in a cost effective way. In the explanatory text for the next similar requirement, the ESAs speak of internal assessment. This should be clarified to be considered as an independent review for example in the recitals. We understand that such review can be conducted purely internally by the legal functions within the in-scope counterparties´ organisations.

We would like to point out that in some jurisdictions, including some EU Member States, a clean netting opinion cannot be obtained. The issue cannot be remedied unless the local bankruptcy legislation is amended to recognize these close-out netting arrangements accordingly. An alternative is to refrain from trading with counterparties in the non-netting jurisdictions. The latter would be an unfortunate and, we believe, unintended consequence of the requirements of Article 2(2) of OPD. Therefore it might be useful to clarify in the RTS that the requirement of Article 2(2) of OPD is satisfied by conducting an “independent legal review” and documenting the conclusions regardless of the result on that legal review with regard to the netting status.

In addition, we would like to seek this article on legal review to be amended in a way that it should be reviewed when there is a change in the legislation covering netting arrangements or when otherwise required. This would further ease the operational burden of such reviews with scarce legal resources within the organisations.

Finally, in light of the recent digital developments there is a risk that the use of the term “written” in this context can be understood to preclude electronic messages and means of recording and documenting. It should therefore either be deleted or replaced by a term with a broader meaning covering any form which ensures an adequate recording and documentation, including electronic records.

Question 6. Respondents are invited to comment on the requirements of this section concerning the legal basis for the compliance.

We understand the need for legally effective and enforceable netting and segregation arrangements. We welcome that the original requirement for the legal opinion on effectiveness of the IM segregation has been replaced by a less cumbersome requirement of an internal legal review. However, the same clarifications as above are needed for this article 1 SEG too.

These amendments are:
1. To clarify in for example a recital that an independent legal review can be done internally. This would not mean that the counterparties could choose to opt for commercial legal reviews as well.
2. To lengthen the period for this review from annually to for example "if and when required" or similar.

In addition, the term "segregated" leaves a bit room for interpretation. It is crucial that the requirements set out under Art 1 SEG will permit reliance on pledge arrangements to provide for the segregation of assets posted as initial margin in the future too.

In many jurisdictions such as the Finnish one, pledge arrangements (meaning legal arrangements where under the securing party grants a security interest in the assets without relinquishing title over the pledged assets) are a very common and widely recognised method of providing collateral without exposing the collateral to insolvency risk of the secured party. Reliance on pledge arrangements in order to achieve segregation would have the advantage that the legal framework is usually well established, ensuring a high degree of legal certainty for both parties. In many jurisdictions it will be almost impossible to find a workable alternative to pledges and even where alternatives may exist, these may actually introduce further or new legal risks.

However pledge arrangements necessarily entail observance of certain legally prescribed formalities which affect the speed by which pledged assets can be realised in the event of a default. Such standard formalities by themselves should not be considered to constitute obstacles preventing a "timely" availability for the purposes of Art. 1 SEG. If pledges could not be relied on to ensure segregation, it will be very difficult to develop workable alternatives, and even where these can be found, these may actually introduce further or new legal risks.

Question 7. Does this approach address the concerns on the use of cash for initial margin?

No comments.

Question 8. Respondents are invited to comment on the requirements of this section concerning treatment of FX mismatch between collateral and OTC derivatives.

It should be possible to include the FX volatility in the initial margin calculation instead of using a standard haircut.

Further, we ask the ESAs to provide clarity on the meaning of the term "transfer currency", and "termination currency". With the given text these have been read as base currency and

close out currency but this interpretation should be strengthened in the RTS.

Finally, there seems to be a mismatch in article 1 FP paragraph 6 where the reference in point (a) should be made to paragraph 3 point (a) instead of the current wording Article 3 (a).

FEDERATION OF FINNISH FINANCIAL SERVICES