Deutsche Bank

EU Transparency Register ID Number 271912611231-56

14 July 2014

Deutsche Bank AG
Winchester House
1 Great Winchester Street
London EC2N 2DB

Tel: +44 20 7545 8000

Direct Tel +44 20 7545 1903
Direct Fax +44 20 7547 4179

ESMA
CS 60747
103 rue de Grenelle
75345 Paris Cedex 07, France

EBA
Tower 42 (level 18)
25 Old Broad Street
London EC2N 1HQ|UK

EIOPA
Westhafenplatz 1
60327 Frankfurt am Main
Germany

Re: Joint European Supervisory Authorities (ESA) consultation on Draft regulatory technical standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012

Dear Sir or Madam,

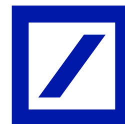
Deutsche Bank welcomes the opportunity to provide comments on the above consultation. Overall we believe that that the draft requirements are reasonably balanced and are broadly consistent with the BCBS-IOSCO final recommendations.

We do continue to have concerns however about the potential pro-cyclicality of the rules if rapid increases in initial margin requirements in future periods of financial instability create new liquidity risks to the financial system which are not addressed in the current proposals. The BCBS-IOSCO monitoring group should keep this potential risk under careful review.

Some of the proposals are inconsistent with the final BCBS-IOSCO recommendations such as the requirement to collect variation margin from non-systemically important non-EU corporates. This requirement should not be included in the final draft RTS in order to avoid inconsistency with the international standards and also in view of the following considerations:

- EMIR level 1 provides the flexibility to treat EU and non-EU corporates consistently. This flexibility is demonstrated by the incorporation into the draft proposals of other key elements of the BCBS-IOSCO recommendations (e.g. the

Chairman of the Supervisory Board: Paul Achleitner
Management Board: Jürgen Fitschen (Co-Chairman), Anshuman Jain (Co-Chairman), Stephan Leithner, Stuart Lewis, Stefan Krause, Rainer Neske, Henry Ritchotte
Deutsche Bank Aktiengesellschaft domiciled in Frankfurt am Main; HRB No 30 000, Frankfurt am Main, Local Court; VAT ID No DE114103379; www.db.com



EUR 8 billion Initial Margin threshold) which were not explicitly provided for in the level 1 text;

- Since EU non-financial counterparties under the clearing threshold will be exempt from exchanging collateral, the requirements will discriminate against non-EU corporates;
- The proposal would place EU firms at a competitive disadvantage as small non-EU corporates without the operational capacity to post margin may prefer to transact with non-EU banks instead who will not be required to collect margin from them.

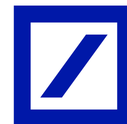
We believe that the requirements to collect variation margin from 1 December 2015 should be phased in to ensure that the necessary changes can be implemented before the requirements start to apply. If the final rules are not published in the EU Official Journal until late Q1 2015, there will be an implementation window of as little as six months until the compliance date. This is insufficient given the scale of the operational and documentation changes required. We therefore suggest two potential approaches on how a phase-in of the variation margin requirements could work in practice. Both aim to ensure the rules are calibrated towards addressing systemically important counterparties while providing sufficient flexibility to take account of the challenges that will arise in the context of transactions with smaller counterparties.

On other issues we have also made proposals which we believe would improve the workability of the rules whilst preserving the objective of reducing systemic risk. For example, we think the requirement to collect collateral should be changed to a requirement to call collateral with delivery occurring in line with standard settlement periods, we support more proportionate concentration limits (especially on sovereign securities) and we suggest that the requirement on the models for calculating margin should be more principles based. On these points and the other issues set out above we trust you will find our suggestions useful and we would be happy to discuss them further.

Please let us know if we can provide further information.

Yours sincerely,

Daniel Trinder
Global Head of Regulatory Policy



PART I - DETAILED COMMENTS

RISK MANAGEMENT PROCEDURES

ARTICLE 1 GEN- GENERAL COUNTERPARTIES' RISK MANAGEMENT PROCEDURES

To ensure legal certainty the final draft requirements should clarify that Article 1 GEN para. 1 does not introduce a retrospective application of the rules dating back to August 2012. The final Basel Committee on Banking Supervision – International Organisation of Securities Commissions (BCBS-IOSCO) recommendations clearly stated that they requirements should apply to "new contracts" entered into from 1 December 2015 in the case of Variation Margin (VM) and from the relevant phase-in dates in the case of Initial Margin (IM). A purely forward looking requirement is also consistent with the European Commission's Frequently Asked Questions document on EMIR implementation which stated that the "technical standards will apply to relevant contracts concluded as of the date that they enter into force".

ARTICLE 2 GEN - RISK MANAGEMENT PROCEDURES IN SPECIFIC CASES

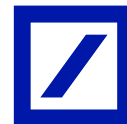
Requiring a formal/written opt-out of the requirement to exchange collateral would place a disproportionate burden on small and medium sized corporates. This is because it will be necessary for counterparties to negotiate and enter into opt-out agreements, a process that will be time consuming and resource intensive. Counterparties should be able to rely on representations from their counterparties that the relevant thresholds have not been breached and collateral does not need to be exchanged.

The final draft Regulatory Technical Standards (RTS) should clarify that prudentially regulated Financial Counterparties (FCs) are not subject to additional capital requirements as a result of para.3. In accordance with the Capital Requirements Regulation (CRR) banks already hold more capital against uncollateralised versus collateralised exposures.

It would be more beneficial if the proposed EUR 500,000 Minimum Transfer Amount (MTA) threshold applied to VM only rather than the total collateral exchanged. It will be a significant operational challenge for the MTA to be calculated for both IM and VM together as the amounts will be calculated separately, potentially with different frequencies and will be subject to different reconciliation and netting requirements. Consideration should also be given to providing a separate MTA for IM. Given that IM needs to exceed EUR 50 million before it is collected, a MTA of EUR 2-5 million would be proportionate unless the proposal on the collection frequency for IM is amended. If IM were to be computed less frequently than currently proposed (e.g. weekly instead of within one business day) then a smaller MTA would be reasonable.

ARTICLE 1 VM - VARIATION MARGIN

Collecting VM within 1 business day would be difficult in practice because margin will be delivered in line with standard settlement dates. Where counterparties are located outside the EU in different time zones, the difficulty in meeting the requirement would be compounded. The final draft RTS should require VM to be called rather than collected. The frequency of the calls should be weekly where the counterparties are not



systemically important. Daily VM calls should only be required for participants that will be captured under the current IM phase-in timetable.

A “big bang” start to the VM collection requirements from 1 December 2015 would be very challenging. The new requirements will necessitate the (re)negotiation of Credit Support Annexes (CSAs) with a large number of counterparties. From a practical perspective it would be extremely difficult to negotiate all the CSAs required during the short period between the finalisation of the RTS and the compliance date. As a result there is a risk that many smaller counterparties will be not be able to access hedging services or they will choose not to hedge due to the fact that the legal and operational cost of daily VM outweighs the risks of not hedging or they simply do not have the operational capability to post and receive collateral. We suggest two potential approaches to address the concerns around the start of the VM requirements:

a) Phase in VM collection requirements (with zero thresholds) in tandem with the IM collection requirements schedule under the EUR 8 billion IM phase-in threshold.

   This would ensure that systemically important counterparties would exchange daily VM with a zero threshold from 1 December 2015 with the remaining counterparties exchanging VM by December 2019.

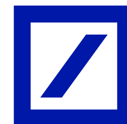
b) Allow counterparties to choose to apply the EUR 50 million threshold against the sum of VM and IM where the collection of IM is not required (as a result of the IM phase-in thresholds). Once the collection of IM is required, the EUR 50 million threshold could only be applicable to IM so that the VM threshold would become zero.

   Under this approach, non-systemically important counterparties would be able to trade without a CSA in place unless they exceeded a mark-to-market (MTM) exposure of EUR 50 million (whereupon a CSA would need to be in place).This would reduce the documentation burden and difficulty of renegotiating CSAs in order to eliminate (generally small) thresholds. The proportion of MTM exposure (approximately 2%) that would be left uncovered as a result of this approach would not be systemically significant. The amount of collateral posted by systemically important counterparties would be the same as what they would post if the threshold was only applied to IM.

The ultimate aim is to arrive at an approach that helps alleviate the particular challenges that arise in the context of smaller counterparties without compromising the objective of reducing systemic risk. For this purpose, both suggestions should be considered as starting points that could be discussed and developed further.

<u>ARTICLE 1 EIM - INITIAL MARGINS</u>

As with the VM requirements, it would be better if the final draft RTS required that IM is called rather than collected within a certain timeframe. Collection of IM will be subject to the standard settlement cycle for the relevant asset. It is also impractical for large counterparties to compute and reconcile IM calculations, resolve issues and deliver IM in one day. Additionally, counterparties may be in different time zones this will add to the complexity. The calling frequency should be weekly as this would not cause any systematic under-collection of IM. On any given day (after initial phase-in) it is equally likely for IM to decrease as increase.



Where a counterparty exceeds the EUR 8 billion IM threshold, consideration should be given to allowing trading to continue without establishing documents until such time that the IM (if it were calculated by the dealer) would reach the EUR 50 million threshold for IM exchange (or e.g. 75% of 50 million). If no documents are in place at that point then further trading should not take place. Such an approach would avoid the need for documentation to be in place when there is no realistic prospect of the IM threshold ever being exceeded. It will also prevent liquidity squeezes for counterparties who suddenly cannot trade any more with many of their counterparties.

In order to ensure legal certainty, the final draft requirements in para. 2 should be clarified to clearly state that counterparties have the option to each call for margin based on their own implemented models.

MARGIN METHODS

ARTICLE 1 MRM - INITIAL MARGIN MODELS

Where the IM model ceases to comply with the requirements, transitional arrangements should be available in the first instance before the use of the Standardised Method is required. The Standardised Method would result in a significant increase in the calculated margin and could result in cliff-effects and potential market disruption. The arrangements could include adding a multiplier (e.g. 1.2 times the internal model result) for a short period of time. This transitional solution would give model users the opportunity to discuss any challenges that have arisen with their models with their regulators and make the necessary changes before the use of the Standardised Method is required.

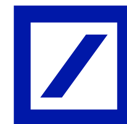
ARTICLE 2 MRM - CONFIDENCE INTERVAL AND RISK HORIZON

We do not think the use of the CRR's definition of Margin Period of Risk is appropriate. The BCBS-IOSCO QIS was based on a 10-day time horizon whereas the CRR definition requires a 20-day time horizon if there are more than 5000 trades or at least 1 illiquid trade in the portfolio. 10 days is longer than required to close out any significant risks on the largest counterparties. A 10-day time horizon should therefore be mandated.

ARTICLE 3 MRM - CALIBRATION OF THE MODEL

We recommend that annual recalibrations are organised by the BCBS-IOSCO Working Group on Margin Requirements in order to assess the appropriate time period for calibration. As currently drafted, requiring the model to be recalibrated every 6 months may increase systemic risk unnecessarily, as will any automated calibration process. The initial and future recalibrations should be carefully controlled in order to mitigate this risk. An impact assessment and QIS could be undertaken to inform any decisions around recalibrations. Where significant changes in the requirements are proposed a phase-in period should be provided to smooth the necessary adjustment.

The current drafting around the requirements for data used in initial margin models in para. 2 includes the terminology "shall cover". To aid operational certainty, it should be clarified that this is a requirement - for the IM that is being collected - to be sufficient to cover the newer historical data and no model parameter adjustments are necessary where the IM is still sufficient.



ARTICLE 5 MRM - INTEGRITY OF THE MODELLING APPROACH

We suggest deletion of the requirements (a) to (i). Instead of these requirements, we recommend that the final draft RTS set general minimum standards. As currently drafted, the requirements are overly prescriptive and could hinder the development of effective models in the tight timeframe before the compliance date. Risk drivers that are material in a systemic sense should be included, but not those for an individual "micro" netting set.

Absent a move to less prescriptive approach we would make the following observations on the current draft requirements:

- As currently drafted para. 1 (a) states that the model shall incorporate interest rate risk factors corresponding to the individual foreign currencies in which the derivatives are denominated. Clarification would be helpful on whether this could mean inclusion of FX conversion risk;

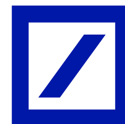
- The current drafting on para.1 (h) on non-linear dependencies should be clarified to state that the requirement refers to the tail dependence assumption upon which some VAR models rely. This is because systemic risk derives from major, linear risk factor sensitivities (such as USD interest rates or general credit spreads widening) rather than non-linear ones (such as USD interest rate gamma or credit spread vega) and thus one of two main objectives of the final BCBS-IOSCO recommendations is covered solely by including linear risk factors while the second objective is not advanced by inclusion of non-linear risk factors. Also, for non-linear risk factor sensitivities, a common convention or interpretation which is used in the market is often not available and therefore apart from the largest market participants the development of such models will be overly burdensome.

ARTICLE 6 MRM – QUALITATIVE REQUIREMENTS

The final draft RTS should clarify the applicable requirement where legally enforceable netting opinions are not available. This is the case in some jurisdictions, particularly many emerging market regions. For jurisdictions where participants cannot obtain satisfactory netting opinions, participants typically do not employ collateral as a risk mitigant. There would be little value to holding collateral since it would need to be returned to the administrator in the event of insolvency.

Insisting on the collection of collateral from counterparties in these jurisdictions may diminish the ability of EU counterparties to impose more effective mitigations such as using limits to contain exposures, re-pricing trades, selling options and using short dated trades. On the contrary, it may increase pressure for EU counterparties to post reciprocal VM which increases the risk that they face.

The same threshold approach as proposed for the phasing-in of VM requirements could be applied. If the IM phase-in criteria were also used for VM it would be unlikely that participants from non-netting jurisdictions would be captured since exposures (and hence notional volume) are carefully limited. If a EUR 50 million threshold was used then currently employed mitigants would likely keep the MTM lower than this value and limit the risks from relying on potentially unenforceable collateral.



ELIGIBILITY AND TREATMENT OF COLLATERAL

ARTICLE 1 LEC - ELIGIBLE COLLATERAL FOR INITIAL AND VARIATION MARGIN

As currently drafted, the RTS state that "The following asset classes shall be eligible as collateral". In the final draft RTS, it should be made clear that counterparties are free to adopt a more conservative approach to the eligibility of collateral should they wish to.

ARTICLE 2 LEC - COLLATERAL MANAGEMENT

Para. 1 (d) requires that access to an active outright sale or repurchase agreement is available. This is not within the control of counterparties. The requirement should be removed in the final draft RTS or the requirement should be amended to instead require that procedures are in place to enable liquidation of collateral.

ARTICLE 4 LEC - CREDIT RISK ASSESSMENT BY THE COLLATERAL TAKER USING THE INTERNAL RATING BASED APPROACH

Please see our response to Q4.

ARTICLE 5 LEC- ELIGIBILITY CRITERIA FOR UCITS

It should be noted that the requirements under para. 1(a) - (c) are out of line with the requirements in the UCITS Directive (2009/65/EC). For example, para. 1(a) requires UCITS/shares to have a daily public price, but the applicable UCITS requirements for the publication of the NAV are on a two-weekly basis.

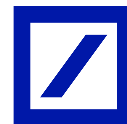
ARTICLE 6 LEC - ELIGIBILITY CRITERIA TO AVOID WRONG WAY RISK

The wrong way risk provisions proposed in para. 1(b) to deal with situations where issuing entities have 'close links' (i.e. 20% or more of the voting rights) to the posting counterparty would be difficult to implement in practice. It is extremely difficult for the parties to always know where close links exist. Also, a holding may not necessarily be highly correlated to the credit risk of the issuer in question. In the final draft RTS the requirement should be limited to wholly or majority owned consolidated subsidiaries.

Further, non specific wrong way risk is not easy to identify in an automated manner. Discretion is therefore required by institutions to determine what collateral is acceptable and/or presents significant risk.

ARTICLE 7 LEC - CONCENTRATION LIMITS FOR INITIAL AND VARIATION MARGINS

We support the BCBS-IOSCO recommendation that collateral should be reasonably diversified which would balance the systemic impact of collateral liquidation with prudent risk management. In going far beyond the final BCBS-IOSCO recommendations the current proposals in the draft RTS present a number of legal, operational and enforcement challenges. Please see our response to Q 5.



ARTICLE 1 HC- CALCULATION OF THE ADJUSTED VALUE OF COLLATERAL

In the context of bilateral exchange of VM, further consideration should be given to the application of haircuts to certain asset classes. There are scenarios where haircuts can shift actual exposure from one entity to another and serves no systemic risk mitigation purpose. For example, if the non-defaulting counterparty has posted collateral, such as the highest quality sovereign debt instruments or gold as VM to the defaulting counterparty (where such entity defaults during a wider market event / has a systemic market effect), it would be quite likely that such collateral would rally upon default and the loss experienced by the non-defaulting counterparty would only be exacerbated.

The final draft RTS should be amended to state that FX haircuts should not be applied to VM. As currently drafted the RTS attempts to mitigate FX risk in two ways. First, when the IM is calculated and second, when the haircut is applied to the collateral. To address the objective of reducing systemic risk it would be more effective to deal with FX risk in one place i.e. the calculation of IM. The FX haircut on VM is not proportionate when considered in light of the treatment regarding IM i.e. the potential change in the MTM value of a trade is not considered to be of systemic importance unless the notional amount of business exceeds the EUR 3 trillion - EUR 8 billion IM threshold and the 10 day risk exceeds EUR 50 million. However, with the FX haircut on VM, the potential change in the MTM value of the collateral / margin is treated as being of immediate systemic importance. Further, additional counterparty risk will be generated by an 8% FX haircut on VM as counterparties will have to take extra credit risk i.e. any counterparty that does not post VM in the currency of its exposure will have to post more VM than its MTM position. We estimate the amount of additional counterparty credit risk could be between EUR 70 and EUR 140 billion. We would be happy to discuss this risk further and provide more information.

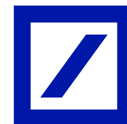
ARTICLE 2 HC - OWN ESTIMATES OF THE ADJUSTED VALUE OF COLLATERAL

In order to ensure appropriately calibrated adjusted values are achieved, a more practical and transparent risk based approach is required for developing methodologies for determining the haircuts on collateral. Such an approach would be consistent with the BCBS-IOSCO recommendations that “haircut requirements should be transparent and easy to calculate, so as to facilitate payments between counterparties, avoid disputes and reduce overall operational risk”. As explained previously the potential change in the value of collateral should be taken account of in the IM calculation (and only for those counterparties who fall in scope for IM) and the meaning of the reference to “internal exposure limits” in para. 7(a) should be clarified.

OPERATIONAL PROCEDURES

ARTICLE 1 OPE- OPERATIONAL PROCESS FOR THE EXCHANGE OF COLLATERAL

The final draft RTS should permit counterparties to agree to allow the substitution of collateral without the other counterparty's consent. The substituted collateral would still have to comply with the eligibility criteria in the final draft RTS and any bi-lateral agreement between the counterparties. Also, counterparties would still be permitted to negotiate that mutual consent is required. A rigid requirement for consent as currently drafted could obstruct the efficient management of collateral, increase the demand on



collateral, restrict the free movement of securities through the system, lead to potential fails and generally eliminate the ability to optimise the portfolio.

ARTICLE 1 SEG - SEGREGATION OF INITIAL MARGINS

The proposal to require segregation of collected IMs may lead to segregation taking place against the interests of the client (for example where operational costs outweigh the benefits). Further, if other jurisdictions do not to require mandatory segregation in their final rules, EU entities would be a competitive disadvantage. It is important that the BCBS-IOSCO monitoring group review the consistency of implementation of requirements in this area.

We suggest that the requirement - for collateral to be immediately available to the collecting counterparty - be amended in the final draft RTS to require that the IM is available in a timely manner. There is no structure which can guarantee immediate availability of IM to the collecting entity in all circumstances. For example, if there is a custodian default, it may take time for the administrators/liquidators to be certain of what is owed to whom. The requirement for immediate availability is incompatible with the concept of segregation as the procedures put in place to ensure segregation will naturally restrict the ability of the secured party to access the IM immediately.

ARTICLE 1 REU - TREATMENT OF COLLECTED INITIAL MARGINS

Rehypothecation of IM under strict conditions was envisaged by the final BCBS-IOSCO recommendations. We do not support the proposal contained in the draft RTS to introduce a full ban on rehypothecation. Please see our response to Q6.

INTRAGROUP DERIVATIVE CONTRACTS

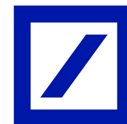
ARTICLE 2 IGT- INTRAGROUP RISK MANAGEMENT PROCEDURES

To increase legal certainty on the scope of the requirement the final draft RTS should provide more clarity on the requirement around “regular monitoring of the intragroup exposures”.

ARTICLE 3 IGT- PRACTICAL OR LEGAL IMPEDIMENT

The final draft RTS should introduce a materiality provision. As currently drafted, the requirements capture almost every jurisdiction and entity. The "shall be deemed to exist" terminology does not allow for any assessment of materiality of impediments. This means that a legal impediment would effectively exist in every jurisdiction with a potential impediment, irrespective of whether there was an actual impediment. This would not allow institutions to determine if potential impediments were, in fact, material, or if there were any mitigating factors.

"Anticipated restrictions" is similarly too broad. Emerging restrictions and regulations in every G20 jurisdiction can be anticipated due to regulatory reforms impacting the banking sector. The point when an "anticipated restriction" becomes sufficiently likely or imminent that it will constitute a legal impediment is also unclear.



FINAL PROVISIONS

ARTICLE 1 FP - FINAL PROVISIONS

The final draft RTS should address a number of important issues regarding the final provisions:

- Exempted FX should be excluded from the threshold calculations (in particular for IM). In the FX market due to the short-dated nature of trades, positions are closed out with a second trade to the same date, whereas for interest rate derivatives, the market practice is to opt for novation due to the long date of trades. As a result there are far greater gross-notional amounts of FX for each unit of real risk. Often counterparties trade to a forward date (like an International Monetary Market date), buy 100 of currency A (vs USD) and then a day later close by selling 100 of currency A to the same date giving gross notional of 200 for a zero risk position. After a short period of time the gross notional position is very large and this is why market participants use "Net Open Position" for all their calculations. Using gross FX notional figures could easily put a counterparty above the threshold for IM when it executes very few trades that are in scope for IM. Documentation and daily calculation would be required even though it is extremely unlikely that the few in-scope trades they execute will require IM. If the current approach is maintained and exempt FX is not excluded from the IM threshold calculations, then at a minimum, the calculation should be made on a net open position basis;

- Consistent with the BCBS-IOSCO recommendations, it should be clarified that the calculation of IM for funds should take place at the fund level, not the consolidated group threshold;

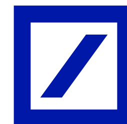
- The final draft RTS should clarify that counterparties should be able to rely on self-certification by their counterparties regarding the calculation of average notional uncleared derivative figures for the purposes of calculating the IM phase-in thresholds.

ANNEXES

ANNEX I - MAPPING OF PD TO CREDIT QUALITY STEPS

Clarification is required on how the requirements would work in practice as differences in rating models of individual counterparties/ECAIs and related observed default rates may result in inconsistent mapping of assets to the Credit Quality Steps (CQS) across the industry. This could lead to disputes and create scope for arbitrage in terms of collateral eligibility. To make the requirements workable, external agencies would have to be required to publish the information necessary to comply with the requirements and ensure consistent mapping.

As the CQS applies only for eligibility of debt securities, as currently drafted the RTS implies that some lower quality corporate bonds/ convertible bonds will not be deemed eligible but the equity of the same issuer would be. The final draft RTS should exclude such equities as being eligible.



ANNEX II - STANDARD HAIRCUTS TO THE MARKET VALUE OF COLLATERAL

It would be helpful if the final draft RTS addressed the following issues:

- The minimum requirements set down by the RTS should not prevent counterparties from applying more conservative haircuts. This will be particularly important for clients where collateral agreements are already in place with more conservative haircuts;

- Clarification is required on whether in the case of swaps, the additional 8% haircut is applied to the settlement currency of the underlying or of the swap pay currency. In relation to portfolio swaps in particular, the underlying equities can settle in many different currencies e.g. HKD, JPY, RMB, MYR etc. Generally the swap pay currency is only in major settlement currencies e.g. EUR and USD. The collateral currency can once again be in any currency if it is non-cash, however if it is cash it will probably be in major currencies. Where the collateral currency and the underlying currency are used, the 8% haircut would be applied in a large number of cases, whereas if the collateral currency and the swap pay currency are used then this would not be the case;

- Bucketing CQSs 2 and 3 together may not be sufficiently risk-sensitive. For example, CQS 3 is likely to contain non-investment grade assets which have sufficiently different risk characteristics and warrant different haircuts. In addition, the jump from CQS 3 to CQS 4 appears too discontinuous (e.g. 6% to 15% for >5yr residual maturity). Residual maturity buckets also do not seem sufficient. The last maturity bucket of >5yr can span (for many sovereign bonds) anywhere from a 5 year bond to a newly-issued 30 year or 40 year bond whose risk characteristics are different enough to warrant different haircuts;

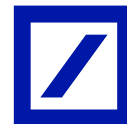
- Where available, consideration should be given to the use of spread rather than the Probability of Default to determine the haircut given that ratings are generally lagging indicators;

- To ensure legal certainty the final draft RTS should clarify the difference between long term and short term debt.

PART II – OVERVIEW OF QUESTIONS

Q1 What costs will the proposed collateral requirements create for small or medium-sized entities, particular types of counterparties and particular jurisdictions? Is it possible to quantify these costs? How could the costs be reduced without compromising the objective of sound risk management and keeping the proposal aligned with international standards?

The requirement to formally opt-out of the requirements on the exchange of margin even where they do not apply would result in a large unnecessary cost in terms of documentation efforts and operational processes. This is due to the significant number of agreements that will have to be negotiated. Smaller counterparties may lose their hedging ability/ be dis-incentivised from adequately hedging their risk. The possibility to rely on “equivalent permanent electronic means” will only be useful to larger counterparties. Pension schemes in particular may find it very difficult to comply with the



concentration limits on collateral. They will have to divert investments so that they can satisfy the requirements.

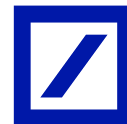
The final draft RTS should ensure that there is no discrimination between EU entities and non-EU entities. The requirement for EU counterparties to collect VM from non-EU corporates - that would be considered non-financial counterparties (NFCs) below the clearing threshold if they were established in the EU - would put EU banks at a competitive disadvantage compared with non-EU banks that are not subject to the same requirements. The lack of a specific reference in Article 11 of EMIR to non-EU entities that would be considered NFCs below the clearing threshold if established in the EU should not prevent the ESAs from treating EU and non-EU corporates equally. The EUR 8 billion IM threshold was not specifically provided for in level 1 either but is nevertheless being proposed in the draft RTS. Article 11 (15)(a) provides the ESAs with a mandate to develop rules on the "levels and types of collateral" that should be exchanged. Therefore our view is that there is no legal impediment to including the further differentiation that is provided in the case of clearing. The final draft RTS should also explicitly specify that all the relevant thresholds are equally available to non-EU entities i.e. the MTA threshold and the EUR 50 million and EUR 8 billion IM thresholds.

Q2 Are there particular aspects, for instance of an operational nature, that are not addressed in an appropriate manner? If yes, please provide the rationale for the concerns and potential solutions.

We believe that a number of aspects require careful consideration in the final draft RTS:

- To ensure legal certainty, the final draft RTS should clarify that the eligibility and other requirements of the RTS should not apply to margin collected that is not required by the RTS i.e. voluntary collateral , collateral collected in excess of the regulatory requirements or before the RTS requirements apply;
- The operational changes required by the new requirements are significant. CSAs will have to be updated and put in place on an industry wide basis during a compressed implementation window. As previously mentioned we believe that VM requirements should be phased in at a minimum;
- Certain definitions in the draft RTS should also be clarified e.g. the meaning of the "netting set" in the margin period of risk and the definition of an FX forward which at present does not refer to a settlement date and could potentially cover spot transactions;
- Where funds are considered EU FCs under EMIR due to the fact that they are managed by an AIFMD authorised manager, these non-EU funds will be required to collect margin (including IM where the EUR 8 billion threshold is breached). The operational burdens they are faced with could result in an increased cost of doing business for them.

Q3. Does the proposal adequately address the risks and concerns of counterparties to derivatives in cover pools or should the requirements be further tightened? Are the requirements, such as the use of the CRR instead of a UCITS definition of covered bonds, necessary ones to address the risks adequately? Is



the market-based solution as outlined in the cost-benefit analysis section, e.g. where a third party would post the collateral on behalf of the covered bond issuer/cover pool, an adequate and feasible alternative for covered bonds which do not meet the conditions mentioned in the proposed technical standards?

N/A

Q 4. In respect of the use of a counterparty IRB model, are the counterparties confident that they will be able to access sufficient information to ensure appropriate transparency and to allow them to demonstrate an adequate understanding to their supervisory authority?

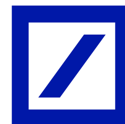
The use of internal rating models in determining collateral eligibility may have an unintended market impact of releasing non-public information to the market. The internal IRBA approved rating models of banks will be based on a combination of public and non public information, and the use of these models to indicate collateral eligibility may result in the collateral taker releasing non public information to the counterparty, particularly where a request for collateral substitution is required due to a change in CQS. Further, use of internal rating models may lead to disputes if there is disagreement on the collateral quality (particularly if the external CQS differs from the internal CQS).

The explanatory text on page 36 of the consultation paper notes that an institution's rating model can also be used by the transacting counterparty. Typically an institution is not permitted to share rating information with public side functions therefore we have some concerns around the requirements to share information with third parties. The final draft requirements should clarify how much information is expected to be shared with the counterparty to allow them to fulfil their obligations under the rules. As some rating models are proprietary, only the underlying principles could be disclosed.

Q 5. How would the introduction of concentration limits impact the management of collateral (please provide if possible quantitative information)? Are there arguments for exempting specific securities from concentration limits and how could negative effects be mitigated? What are the pros and cons of exempting securities issued by the governments or central banks of the same jurisdiction? Should proportionality requirements be introduced, if yes, how should these be calibrated to prevent liquidation issues under stressed market conditions?

We agree that proportionality requirements should be introduced. The current proposals on concentration limits would result in a significant operational burden around the management of collateral. The draft requirements are particularly problematic as regards sovereign debt as in many jurisdictions it is the main form of collateral used. Also, to comply with the proposed limits, pension plans and insurers would potentially need to obtain cash or other securities if they wished to hedge their risks through OTC derivatives. Otherwise, they may not be able to adequately hedge. Further, the concentration limits assume that FCs and NFCs above the clearing thresholds accepting collateral will always be able to identify whether issuers are part of the same "group" within the meaning of EMIR.

To ensure the rules are appropriately calibrated, a QIS could be undertaken and further rules drafted if required. In the meantime national regulators should monitor how



counterparties' practices correspond to the BCBS-IOSCO recommendations around collateral being reasonably diversified.

At a minimum, high quality government bonds should be removed from the requirement while single issuer concentration limits and a cap on all non-government bonds could be put in place (including corporate bonds which are excluded from the concentration limits). Also, to prevent the limits being subject to arbitrage by posting excess collateral, any concentration limit should be expressed as a percentage of a counterparties' margin requirement under the CSA as opposed to a percentage of the collateral received.

Q 6. How will market participants be able to ensure the fulfilment of all the conditions for the reuse of initial margins as required in the BCBS-IOSCO framework? Can the respondents identify which companies in the EU would require reuse or re-hypothecation of collateral as an essential component of their business models?

While the BCBS-IOSCO conditions on rehypothecation are unlikely to be achievable in the short term, they could be achievable over time. Were other jurisdictions not to introduce an outright ban in their final rules and a model for rehypothecation is developed which meets the conditions of BCBS-IOSCO, EU banks would be at a clear competitive disadvantage. The final draft RTS should therefore state that rehypothecation is possible where the conditions set out by BCBS-IOSCO are fulfilled. This would ensure that international consistency and emerging rehypothecation models could be kept under review by the ESAs and the BCBS-IOSCO monitoring group.