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July 18, 2017

Via Online Submission

Directorate-General for Financial Stability, Financial Services and Capital Markets Union
European Commission
1049 Brussels
Belgium

Re: *Proposed Amendments to EMIR Regarding the Clearing Obligation, the Suspension of the Clearing Obligation, the Reporting Requirements, the Risk-Mitigation Techniques for OTC Derivatives Contracts Not Cleared by a Central Counterparty, the Registration and Supervision of Trade Repositories and the Requirements for Trade Repositories*

Dear Sir or Madam:

ICI Global[1] appreciates the opportunity to comment on the proposed amendments of the European Commission (Commission) to the European Market Infrastructure Regulation (EMIR).[2] This letter provides our views on how to make EMIR's clearing and reporting obligations more proportionate and effective. We also propose two steps that the Commission should take to ensure that EMIR does not impose disproportionate costs and burdens on cross-border derivatives transactions.

Regulated funds—market participants representing millions of investors—use derivatives in a variety of ways and generally support reforms that improve oversight, efficiency, fairness, and transparency of the derivatives markets. Derivatives are a particularly useful portfolio management

[1] ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US$25.5 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC.

[2] *See* Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivatives contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories, dated 4 May 2017, *available at* https://ec.europa.eu/info/law/better-regulation/initiative/25623/attachment/090166e5b21c0862_en.

tool in that they offer regulated funds considerable flexibility in structuring their investment portfolios. A regulated fund can use derivatives to hedge positions, equitize cash that it cannot immediately invest in direct equity holdings, manage cash positions, and adjust portfolio duration, all in accordance with the investment objectives stated in the fund's prospectus.

We strongly support the Commission's goals of amending EMIR to eliminate disproportionate costs and burdens and to simplify rules without compromising the objectives of EMIR. Because the derivatives markets are predominantly cross-border markets, we also support efforts for real and meaningful regulatory coordination among international regulators that will ensure investors and others benefit from a vibrant, global derivatives market.

I. The Commission's Proposal to Amend the Clearing Obligation Generally Would Promote Stable Cleared Derivatives Markets

Article 4 of EMIR imposes a clearing mandate on over-the-counter (OTC) derivatives transactions involving certain counterparties. We believe that central counterparty (CCP) clearing is a useful tool for mitigating counterparty credit risk and preventing the build-up of systemic risk, when properly implemented and accompanied by appropriate safeguards. We detail our views on a number of the proposed amendments to the clearing obligation below.

A. The Commission Should Rescind the Frontloading Requirement

We strongly support the proposed elimination of EMIR's frontloading requirement, which obligates counterparties to clear an existing, uncleared derivatives contract if a clearing mandate takes effect for the relevant product, the contract was entered into during the "frontloading period," and the contract has a specified minimum remaining maturity.[3]

This frontloading requirement has the potential to disrupt pricing and liquidity in EU derivatives markets. The costs and risks associated with a derivatives contract are assessed at the time of execution and vary depending on whether the contract will be cleared. Current pricing models do not account for uncleared contracts that will migrate to clearing after a significant period of time. As a consequence, a frontloading requirement could cause market participants to: (1) curtail their activity in transactions subject to frontloading to the detriment of market liquidity; or (2) terminate a large number of contracts at the expiry of the phase in period. Either outcome could significantly damage or disrupt the derivatives markets, and we believe that whatever benefits might result from frontloading do not outweigh the potential costs.

We believe the proposal to abolish EMIR's frontloading requirement will improve market stability by reducing the unnecessary risks and uncertainty attendant to this requirement and recommend that the Commission proceed with this amendment as proposed.

B. The Commission Should Provide a More Rapid Mechanism for Suspending the Clearing Mandate

Adopting a mechanism for quickly suspending the clearing obligation when it is no longer appropriate would increase confidence in the derivatives markets. EMIR provides no exception

[3] *See* Proposed Regulation at Article 1.

from the clearing requirement for potential market events that could make clearing impossible—*e.g.*, if the dominant or only CCP for a particular product exits the market. Unfortunately, EMIR requires the adoption of regulatory technical standards (RTS) to remove a clearing mandate, even on a temporary basis, and adopting new RTS can take a significant amount of time. The absence of an effective and timely mechanism to suspend the clearing obligation could add unnecessary risk and confusion during stressful market events.

ICI Global supports the objectives of Article 1(3) of the proposed regulation, which contemplates that the Commission would have the authority to suspend the clearing obligation after ESMA makes a request, accompanied by supporting data. In certain circumstances, ESMA would be required to consult with the European Systemic Risk Board prior to submitting the request to the Commission. The Commission would have 48 hours after receiving ESMA's request to either suspend the clearing obligation or reject the requested suspension.

Although proposed Article 1(3) would be a significant improvement over the current process for suspending the clearing obligation, we remain concerned that economic events could move faster than the two-day time period contemplated by the proposal. A single authority should have the authority to act directly and immediately to ensure that an existing clearing mandate does not exacerbate potential financial stress.[4] One option would be to empower ESMA to issue unilaterally a brief suspension and then request a longer suspension from the Commission. This suspend-and-request framework would ensure that a single EU authority has the ability to intervene directly and quickly to stabilize markets during an uncertain time while also ensuring that policy makers have a prompt opportunity to review and, if necessary, rescind the determination.

C. The Commission Should Adopt Proposed Protections for Customer Funds in the Event a CCP or Clearing Member Defaults

ICI Global strongly supports efforts to protect customer funds held by a defaulting CCP or clearing member. Accordingly, we welcome the proposed amendments to Article 39, which would clarify that customer assets shall not be considered part of the insolvency estate of a CCP or clearing member. We understand that the intent of the proposal is to provide a minimum standard across the European Union for protecting customer funds in the event of a clearing member or CCP insolvency. We strongly support this goal and encourage the Commission to engage proactively with other relevant authorities to ensure the amendments have their desired effect.

Clarifying the circumstances under which customer assets would be bankruptcy remote would encourage customers to transact confidently in derivatives markets in a couple of ways. First, clarity would provide customers with a clear roadmap to maximize the protections available to their assets held by clearing members or CCPs. Second, ensuring the bankruptcy remoteness of customer positions and collateral would reduce customer risks by enhancing the portability of customer positions to a solvent clearing member or CCP.

[4] The Commission should confirm that a suspension of a clearing mandate would not prohibit voluntary clearing of derivatives products, to the extent possible.

D. The Commission Should Provide Relief from Mandatory Clearing for Small Financial Counterparties

We support the proposal to implement a clearing threshold for small financial counterparties. When EMIR's clearing mandates take effect fully, any financial counterparty that does not have access to clearing services would be prohibited effectively from entering into a derivatives transaction subject to a clearing mandate. Unfortunately, the costs associated with central clearing—including potentially high up-front costs associated with establishing clearing relationships and ongoing costs associated with clearing trades—may impose disproportionate burdens on some small financial counterparties. The proposed threshold would ensure that the smallest financial counterparties can continue using derivatives in a limited manner and should not detract from the risk mitigation benefits provided by central clearing more generally.

II. We Support the Proposed Amendments to the Reporting Obligation, but They Fall Short of the Change Needed to Reduce Disproportionate Burdens and Improve Data Quality

We appreciate and generally support the modest changes that the Commission proposes to EMIR's reporting requirements, but the Commission should embrace more fundamental change to this regime. Specifically, we recommend that the Commission replace EMIR's dual-sided reporting framework with a single-sided mandate. The Commission also should proceed with its proposals to eliminate reporting requirements for terminated or expired historical transactions and to require CCPs to report exchange-traded derivatives.

A. The Commission Should Propose a Single-Sided Reporting Regime

EMIR requires both counterparties to a derivatives transaction to report certain details of the trade to a trade repository.[5] This dual-sided reporting requirement imposes unnecessary costs and other burdens on buy-side market participants, including our members. Buy-side firms experienced significant challenges in implementing EMIR reporting requirement in advance of its effective date in February 2017 and they face ongoing operational challenges in fulfilling their Article 9 obligations, including complications with generating and reporting unique trade identifiers (UTIs), establishing and supervising delegated reporting obligations, and reporting terminated historic transactions. These obligations continue to impose ongoing burdens on buy-side market participants even after the initial infrastructure system had to be developed to comply with the reporting requirements.

Despite the considerable efforts and resources devoted to compliance, we understand that the quality of data reported to trade repositories under EMIR's dual-sided reporting mandate is still quite low—the report submitted by one side of a transaction frequently does not match the report submitted by the other side, usually due to minor differences in reporting conventions rather than discrepancies in economic terms. The reporting errors that result from these data mismatches frustrate regulatory efforts to assess derivatives trading activities and counterparty exposures and impose unnecessary burdens on counterparties. Therefore, we see little or no benefit and significant

[5] *See* Article 9 of EMIR.

harm to continuing dual-sided reporting. We also remain deeply concerned that regulators are making policy recommendations based on this questionable data.[6]

Given the practical difficulties experienced by market participants and the low quality of data reported to trade repositories, the Commission should replace the current dual-sided reporting regime with a single-sided mandate that requires reporting by the counterparty with the greater capacity to report a transaction. A single-sided reporting regime would address many of the challenges of the dual-sided reporting framework, including those associated with delegated reporting, UTIs, and the widespread issues associated with differing reporting conventions causing mismatching trade reports. Single-sided reporting would not increase risk or reduce the quality of records kept by counterparties because existing risk mitigation techniques (such as reconciliation, dispute resolution, and timely confirmation requirements) will ensure that counterparties will address promptly and properly any discrepancies in key trade terms. Moreover, moving to a single-sided reporting regime likely will improve data quality for regulators and reduce costs to industry participants.

The Commission could establish single-sided reporting obligations directly or direct ESMA to construct a single-sided reporting regime. At a minimum, a CCP should have the sole responsibility for reporting exchange-traded derivatives as well as any derivative to which it is a counterparty. For other derivatives contracts, the dealer should have reporting responsibility any time that it enters into a contract with a non-dealer. Dealers have the resources and infrastructures already in place to report derivatives transactions, as evidenced by their ability to offer delegating reporting services. Reporting requirements for other transactions (particularly those between two dealers) should be determined according to the reporting abilities of the relevant counterparties, in consultation with relevant industry participants.

B. The Commission Should Not Require Reporting of Terminated or Expired Historic Transactions

The Commission should proceed with its proposal to eliminate reporting requirements for derivatives transactions that were outstanding on or after 16 August 2012, but terminated or expired prior to the start of EMIR reporting on 12 February 2014. The Commission has recognized previously that market participants may face great difficulty in obtaining all of the relevant information with respect to these historic transactions,[7] and we agree completely with this assessment.

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[6] *See* ICI Global Response to ESMA's Consultation on the Trading Obligation for Derivatives at 12-13, *available at* https://www.esma.europa.eu/press-news/consultations/consultation-trading-obligation-derivatives-under-mifir (explaining how challenges associated with the quality of data reported to EU trade repositories could cause ESMA to overestimate liquidity in certain derivatives instruments that could become subject to the trading obligation).

[7] *See* Commission Implementing Regulation (EU) 2017/105 of 19 October 2016 amending Implementing Regulation (EU) No 1247/2012 laying down implementing technical standards with regard to the format and frequency of trade reports to trade repositories according to Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories, *available at* http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0105&from=EN.

Requiring reports of terminated or expired historic transactions would impose a considerable burden on counterparties, especially because delegated reporting offerings—on which many regulated funds rely to comply with EMIR's reporting rules—do not provide for the reporting of these trades. To report terminated or expired trades, firms would be required to put in place new delegated reporting arrangements or develop infrastructures to facilitate self-reporting just for those transactions. We do not believe the significant costs and efforts required to report terminated or expired historic trades are proportionate to the minimal benefit that regulators could obtain from having access to data for transactions that no longer exist.

C. Clearing Houses Should Report All Exchange-Traded Derivatives

As noted above, we believe that CCPs should be responsible for reporting all exchange-traded derivatives contracts, which are standardised, matched at an exchange, and cleared by a CCP. The CCP that clears an exchange-traded derivative will have directly or will obtain from the relevant exchange all pertinent information about the transaction. CCPs, as market infrastructures with broad market connectivity and information sharing ability, are ideally positioned to report this data compared to other market participants, especially the buy-side.

We therefore support the spirit of Article 1(7) of the proposed regulation, which would make CCPs "responsible for reporting on behalf of both counterparties the details of derivative contracts that are not OTC derivative contracts as well as for ensuring the accuracy of the details reported." The preamble to the proposed regulation notes that the CCP would be "responsible, and legally liable," for making these reports.

We believe the Commission intends this proposed modification to require a CCP to report any exchange-traded derivatives contract that it clears and to remove any reporting obligation from the counterparties to the transaction. To make this intent clear, we suggest that the Commission remove any references to a CCP reporting "on behalf" of the counterparties, because this language could be interpreted to suggest that the counterparties retain some form of reporting obligation that is performed by the CCP.[8] In this circumstance, counterparties could feel obligated to verify that the CCP has reported correct information or, at a minimum, attempt to verify that the CCP has adequate processes and procedures in place to report on their behalf. Either scenario would impose a disproportionate and unnecessary burden on trade counterparties and, potentially, create uncertainty about who could be liable if a CCP fails to report a trade or reports inaccurately. In addition, unambiguously placing reporting requirements on CCPs likely would improve the quality of data reported to trade repositories by: (1) placing reporting obligations on only one entity; (2) requiring reporting from the entity that has the best access to all information about the relevant transactions; and (3) providing no doubt about liability if the CCP fails to report as required.

[8] The Commission could remove the "on behalf" of language by revising its proposal to state that a CCP "shall report the details of derivative contracts that are not OTC derivative contracts" and that counterparties shall have no reporting obligations for these trades.

III. The Commission Should Amend the Proposal to Limit Appropriately the Territorial Application of EMIR

Derivatives markets are global in nature, with many transactions occurring between counterparties established in different jurisdictions. The global character of derivatives markets improves liquidity and resiliency by enabling market participants to transact with a wide range of counterparties that have varied trading objectives and diverse risk sensitives. If regulation reduces market participants' ability to transact across borders, liquidity will fragment and markets will become less efficient and likely more volatile. ICI Global believes that derivatives regulators should coordinate to avoid duplicative and/or conflicting regulation that could disrupt derivatives markets.

We urge the Commission to use the EMIR review process to further this goal in two ways. First, the Commission should amend the proposed definition of financial counterparty to ensure that EMIR does not extend to counterparties and transactions that have no or only inconsequential connection to the European Union. Second, the Commission should use the EMIR review process to provide equal treatment to third-country and EU funds for purposes of the risk mitigation techniques for uncleared OTC derivatives.

A. The Proposed Definition of Financial Counterparty is Too Broad and Will Create Legal Uncertainty for Third-Country Entities

The Commission should tailor the proposed definition of "financial counterparty" in Article 1(1) to avoid applying EMIR to funds with little or no connection to the European Union. In its current form, the proposal would cause all alternative investment funds (AIFs), anywhere in the world, to be considered financial counterparties, even those established and managed outside the European Union—including US registered investment companies (RICs)—and even if they have no or minimal EU contacts. Because the full force of EMIR applies to all financial counterparties, third-country AIFs with no connection to the union would be responsible for EMIR compliance for all of their transactions, including those with other non-EU counterparties. The EU authorities have no regulatory interest in AIFs that have little or no connection to the European Union and do not transact with EU counterparties. We strongly urge the Commission to revise its proposal and apply the definition of "financial counterparty" only to AIFs with an adequate level of connection to the European Union.

To ensure that EMIR applies only to AIFs that have a sufficient nexus to the European Union, the Commission should revise its proposal to apply the "financial counterparty" definition only to those AIFs that "are established in the EU or managed by an AIFM authorised or registered in accordance with Directive 2011/61/EU." Alternatively, the Commission could specify that the definition of "financial counterparty" includes only those AIFs that meet the definition of "EU AIF" in Article 4 of Directive 2011/61/EU. Either approach would be consistent with the present, measured territorial application of EMIR[9] and would allow EU regulators to protect EU derivatives markets and EU counterparties.

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[9] The definition of "non-financial counterparty," for example applies only to an undertaking established in the European Union other than a CCP or a financial counterparty. *See* Article 2(9) of EMIR. ESMA has interpreted other EMIR provisions as applying only to a transaction that includes at least one EU counterparty. *See e.g.*, Questions and

B. The Commission Should Amend the Risk Mitigation Techniques for Uncleared OTC Derivatives to Ensure Uniform Application of the Group Definition

We believe the risk mitigation techniques for uncleared OTC derivatives in Article 11 of EMIR and the associated RTS should allow all investment funds to calculate their aggregate average notional amount of uncleared derivatives independently, rather than requiring certain funds to perform this calculation at the group level. The aggregate average notional amount of uncleared derivatives determines a counterparty's compliance date and plays a role in determining whether the counterparty is required to post initial margin.[10] The RTS establish a methodology for a counterparty to calculate its aggregate average notional amount of uncleared derivatives. If the counterparty consolidates its financial statements with one or more other entities, each consolidated entity also performs this calculation and these amounts are combined to determine the average aggregate notional amount for the group as a whole.[11] Counterparties that belong to a group must use the group-level notional amount to determine certain compliance obligations under the RTS.

The final RTS implementing the risk mitigation techniques in Article 11 of EMIR grant deconsolidation for funds consistent with the international agreed upon standards published by BCBS and IOSCO.[12] Unlike in the international agreed upon standards, however, the RTS limit deconsolidation only to undertakings for collective investment in transferable securities (UCITS) authorised in accordance with Directive 2009/65/EC and AIFs managed by alternative investment fund managers and authorised or registered in accordance with Directive 2011/61/EU (EU Managed AIFs). UCITS and EU Managed AIFs calculate their exposure independent of any other entity, provided that: (1) the funds are distinct segregated pools of assets for the purposes of the fund's insolvency or bankruptcy; and (2) the segregated pools of assets are not collateralised, guaranteed, or otherwise financially supported by other investment funds or their managers. Other funds (which include most third-country funds) must include in their exposure calculations the

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Answers: Implementation of the Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR), at answer 12(b) (explaining that Article 11 of EMIR, which pertains to risk-mitigation techniques for uncleared OTC derivatives contracts, applies where at least one counterparty is established within the EU).

[10] *See* Articles 28(3) and 39(2) of Commission Delegated Regulation (EU) 2016/2251 of 4 October 2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty, *available at* http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R2251&from=EN.

[11] Article 2(16) of EMIR defines group as "the group of undertakings consisting of a parent undertaking and its subsidiaries within the meaning of Articles 1 and 2 of Directive 83/349/EEC or the group of undertakings referred to in Article 3(1) and Article 80(7) and (8) of Directive 2006/48/EC." Under each of these standards, two entities are in the same group if they consolidate their financial statements.

[12] Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, Margin requirements for non-centrally cleared derivatives (March 2015) at n. 10, *available at* http://www.bis.org/bcbs/publ/d317.pdf ("Investment funds that are managed by an investment advisor are considered distinct entities that are treated separately when applying the threshold [for mandatory exchange of initial margin] as long as the funds are distinct legal entities that are not collateralised by or are otherwise guaranteed or supported by other investment funds or the investment advisor in the event of fund insolvency or bankruptcy.")

aggregate average notional amount of any other entity with which they consolidate under accounting rules.[13]

We see no policy rationale for distinguishing EU and non-EU funds for purposes of consolidation. The underlying principle behind the deconsolidation for funds—recognition that funds within a group should be looked at as distinct entities and that the appropriate level at which risk should be assessed is at the individual fund level—does not change because a fund is an EU or non-EU fund as long as the conditions for the deconsolidation are satisfied. The preferential deconsolidation treatment for UCITS and EU Managed AIFs discriminates unfairly against third-country funds[14] and conflicts with the intent stated in recital 13 of the risk mitigation techniques RTS[15] and with the deconsolidation standard applicable to investment funds in the RTS implementing the clearing obligation for derivatives.[16] These differing standards create unnecessary compliance costs by forcing third-country funds to apply two different aggregation standards. We urge the Commission to use the EMIR review to ensure that third-country funds are not required to consolidate their average aggregate notional amount with any other entity to the same extent as UCITs and EU Managed AIFs.

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[13] *See* Article 2(16) of EMIR (defining "group").

[14] US derivatives regulation, including the margin rules adopted by the Commodity Futures Trading Commission, provides equal treatment to US and third-country funds with respect to deconsolidation. US regulators also agreed to treat US registered funds and third-country public funds (such as UCITS) equally in the Volcker Rule. The final Volcker Rule exempts both types of funds from the rules restrictions.

[15] According to that recital, although consolidation at the group level is generally appropriate, "investment funds should be treated as a special case as they can be managed by a single investment manager and captured as a single group. However, where the funds are distinct pools of assets and they are not collateralised, guaranteed or supported by other investment funds or the investment manager itself, they are relatively risk remote in relation to the rest of the group. Such investment funds should therefore be treated as separate entities when calculating the thresholds, in line with the BCBS-IOSCO framework." The rationale provided in this recital applies to all investment funds, not to just UCITS and EU AIFs.

[16] *See* Commission Delegated Regulation (EU) 2015/2205 of 6 August 2015 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation, *available at* http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R2205&from=EN. According to Article 2(3) of this RTS, "[w]here counterparties are alternative investment funds as defined in Article 4(1)(a) of Directive 2011/61/EU or undertakings for collective investment in transferable securities as defined in Article 1(2) of Directive 2009/65/EC of the European Parliament and of the Council, the EUR 8 billion threshold referred to in point (b) of paragraph 1 of this Article shall apply individually at fund level." (Internal citation omitted.) The relevant threshold determines when a particular counterparty must start clearing its derivatives transactions. Recital 6 to this RTS notes that the threshold was aligned with international standards and, consistent with "those international standards, whereas the threshold applies generally at group level given the potential shared risks within the group, for investment funds the threshold should be applied separately to each fund since the liabilities of a fund are not usually affected by the liabilities of other funds or their investment manager. Thus, the threshold should be applied separately to each fund as long as, in the event of fund insolvency or bankruptcy, each investment fund constitutes a completely segregated and ring-fenced pool of assets that is not collateralised, guaranteed or supported by other investment funds or the investment manager itself."

We appreciate the opportunity to provide input on the Consultation. If you have any questions on our letter, please feel free to contact the undersigned, Jennifer Choi, Associate General Counsel, at (202) 326-5876, or George Gilbert, Counsel, at (202) 326-5810.

Sincerely,

/s/ Dan Waters

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