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Directorate-General for Financial Stability, Financial Services and Capital Markets Union
FINANCIAL MARKETS

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PUBLIC HEARING ON THE REVIEW OF EMIR
29 May 2015

1. OPENING REMARKS: JONATHAN HILL, COMMISSIONER FOR FINANCIAL STABILITY, FINANCIAL SERVICES AND CAPITAL MARKETS UNION

The Commissioner's speech is available at: http://europa.eu/rapid/press-release_SPEECH-15-5080_en.htm

2. PANEL 1 – CENTRAL COUNTERPARTIES

Moderator: **Steven Maijoor**, Chair, European Securities and Markets Authority (ESMA)

Panellists: **Fredrik Ekström**, CEO, NASDAQ OMX Clearing

Frédéric Hervo, Director of Payment Systems and Market Infrastructure, Banque de France

Thomas Book, CEO, Eurex Clearing

Pietro Stecconi, Chair of CCP Task Force, European Systemic Risk Board (ESRB)

Graham Young, Head of FMI Risk, Research and CCP Policy, Bank of England

The moderator noted that ESMA supports the EMIR review, and welcomed the announcement of the Commissioner that the first set of EU clearing obligations would shortly be adopted. The main issues he highlighted were the following:

- The role and structure of CCP colleges;
- Account structures: there have been technical challenges with segregation models;
- The prudential provisions of EMIR and the default waterfall;
- The interaction with third countries and the practice of deference.

Fredrik Ekström focused on margins and collateral. In particular he noted that:

- Under the RTS on portfolio margining (Article 27) it is difficult to determine the definition of a 'reliable and significant' correlation. He recommended focussing on general principles to describe the relationship between correlations and offsets, as well as a move towards more model-independent definitions.
- For collateral, the balance is not right for non-financial companies (NFCs) that are clearing members. He suggested allowing bank guarantees that are not fully-backed by collateral to continue to be posted as margin by NFC clearing members in electricity and gas markets. If the exemption permitting this expires in March 2016, then these NFCs will leave the cleared market and execute transactions over the counter which may not be cleared - or clear as clients.

Frédéric Hervo focused on supervision and colleges. He stressed that an effective supervisory framework for CCPs should fulfil three criteria, namely rely on requirements commensurate to the systemic importance of CCPs, ensure a consistent implementation across the EU, and be tailored to the specificities of CCPs. He considered the framework to fulfil these criteria. In particular, the EMIR college framework has been functioning well and strikes the right balance between an important role for national competent authorities and an effective cooperation among all supervisory stakeholders, including the ESMA role to ensure a consistent implementation throughout EU.

He made two recommendations for improving the EMIR supervisory framework:

- Streamline provisions under Article 49(1) with regard to model changes as these are currently too cumbersome; and
- National competent authorities (e.g. central banks) that are not part of ESMA should be involved in the interpretation of the RTS, in light of their responsibilities, expertise and initial cooperation in the preparation of RTS.

Thomas Book considered the review relatively early in light of the fact that not all elements of EMIR are fully implemented yet, He emphasised that EMIR has been well thought through, so that there should not be many changes necessary. The focus should therefore be on the following elements:

- More broadly, international consistency should be strived for. A 2 day Margin Period of Risk is adequate whereas a 1 day standard is too short;
- With a view to ensuring financial stability and integrity, he stressed that CCPs need access to central bank liquidity. He noted that the Bank of England changed its policy to grant access to CCPs without them needing a bank licence and a different approach by the ECB creates an non-level playing field and should be addressed.
- He suggested that - with respect to portfolio margining - provisions on required correlations should be modified; it would be good to reflect on more state of the art, portfolio-based, approaches.
- Finally, he made the observation that there is a strong link between the EMIR waterfall and CCP recovery and resolution. EMIR should remain the key regulation for CCPs, i.e. synergies between EMIR and the CCP recovery and resolution dossier should be ensured.

Pietro Stecconi noted the increased systemic importance of CCPs and hence the growing macro-prudential attention for them, since they manage risk, and reduce counterparty credit exposures, act as circuit-breakers in case of a participants' default. CCPs therefore, in addition to fulfilling the EMIR requirements, also need adequate recovery strategies. ESRB will provide reports on procyclicality and, later on, on interoperability arrangements to the Commission. On stress testing, scenarios have to consider historical and hypothetical market moves; there needs to be international consistency in how these are designed.

Graham Young noted that EMIR has raised prudential standards and that it is too early to consider extensive changes, although there are some areas where lessons have been learned from applying EMIR and where technical changes should be considered. The Bank of England has established global colleges for CCPs, and supports the college framework in EMIR although it is important that accountability is clear and that colleges focus on the most significant issues. The RTS on portfolio margining has been difficult to apply and the RTS on procyclicality should impose a broader requirement on CCPs to set out their overall approach to mitigating pro-cyclicality. He also supported further international work at CPMI-IOSCO, FSB and BCBS as it develops.

Q&As

A CCP industry representative supported the RTS for portfolio margining to be made model independent and for EMIR to make the approval of new products easier so that innovation is not prevented. Representatives of utilities providers in Nordic markets showed support for bank guarantees to be allowed as collateral in utilities markets. Finally, a representative of the pensions industry underlined support for central bank liquidity to be made available to CCPs.

3. PANEL 2 – NON-FINANCIAL CORPORATE COUNTERPARTIES

Moderator:	**Tom Springbett**, Derivatives Reform Manager, UK Financial Conduct Authority
Panellists:	**Alberto Pototschnig**, Agency for the Cooperation of Energy Regulators (ACER)
	Christian Sigmundt, Director, Bundesanstalt für Finanzdenstleistungsaufsicht
	Stephen Baseby, Associate Policy & Technical Director, European Association of Corporate Treasurers
	Barney Reynolds, partner and Global Head, Financial Institutions Advisory and Financial regulatory practice, Shearman & Sterling LLP

The moderator explained that regulators have received a lot of questions from non-financial companies as implementing EMIR has been challenging. The main issues raised were the following:

- Is the EMIR hedging threshold the right one?
- Should all types of Non-Financial Counterparties (NFCs) be treated the same?
- Does the application of the reporting obligation to all NFCs make sense?

Alberto Pototschnig focused on the EMIR implementation issues which could adversely affect the energy market. In particular:

- ESMA's extensive Q&As, which are not legally binding and for which ESMA has no mandate, are being heavily relied upon;

- The very different formats for data collection that are being used by trade repositories, which may be problematic for data reconciliation and which are not consistent with REMIT reporting;
- Delegated powers to ESMA under EMIR (Level 3) may facilitate implementation significantly and increase flexibility;
- Some EMIR requirements may impose additional costs on hedging activities;
- Whether physical forward energy transactions should be considered derivative transactions. In this respect, market supervision, which, if disproportionate with respect to the level of systemic risk, may have important effects on energy markets and reduce their liquidity, should be left to energy regulators.

Christian Sigmundt shared the view that EMIR has introduced challenges for the different hedging strategies of NFCs. Moreover, it is very difficult for a regulator to get the information it needs from small firms. BAFIN has therefore built a relationship with the auditors of those firms or with their banks, an approach which has worked well. The concept of "undertaking" for the purposes of the definition of NFC should be clarified and reviewed to take into account the difficulties that EMIR imposes on small companies. In addition, he raised questions about the definition of a "derivative" which is quite uncertain since it relies on MIFID. Finally, he suggested consideration of whether reporting of intragroup transactions by NFCs should be reflected upon in the context of the single-sided/dual-sided reporting issue. However, it should be recognised that NFCs can also bring systemic risks to the market, be it in exceptional cases.

Stephen Baseby highlighted the difficulties caused by inconsistencies between EMIR and third country regulations, in particular with the Dodd Frank Act. This can lead to a disadvantage for EU firms. He questioned the need for NFCs to report, as they are not systemically risky, and do not benefit from the protections of the regulatory system in the same way as FCs. He suggested that the reporting obligation of NFCs should be reconsidered, with particular focus on the following:

- What is included in the trade report;
- To whom the obligation applies and whether this is necessary;
- The need for international consistency in order to avoid disadvantaging the EU.

Finally, with regards to the impact on NFCs of EMIR, he mentioned that data shows interest derivative use by NFCs has fallen since 2008 (and further since EMIR was introduced), although the exact reasons for this will not be known until underlying interest rates rise.

Barney Reynolds agreed with the remarks made by the other panellists and focused on the application of EMIR to third country entities, in particular funds and public bodies since it is not clear into which category they fall. The way in which the terms "financial counterparty" and "non-financial counterparty" are interpreted for third country entities should be clarified, possibly in ESMA's Q&As or the revised RTS. Finally, he indicated support for single-sided reporting.

<u>Q&As</u>

Questions were raised by a bank representative on the concept of "undertaking" for the purposes of the definition of an NFC and whether there was a possibility to set up a database including the types of entities which are considered NFCs. Participants from the financial and non-financial sectors supported single-sided reporting instead of dual-sided reporting and exempting from the reporting obligation transactions and/or firms which do not threaten financial stability.

4. Panel 3: Clearing and Risk Mitigation Techniques

Moderator: **Jennifer Robertson**, European Commission, Directorate General for Financial Stability, financial Services and Capital Markets Union

Panellists: **Mireille Dyrberg**, Chief Operating Officer, Trioptima

Marieke van Berkel, Head of Department Retail Banking, Payments, Financial Markets, European Association of Cooperative Banks

Simon Puleston Jones, CEO, FIA Europe

Patrice Aguesse, Head of Market and post-Market Regulation Policy Division, Autorité des marchés financiers (AMF)

The moderator explained that risk mitigation techniques were among the first requirements to be implemented and asked panellists whether these requirements had the effect of promoting product standardisation and legal certainty that was aimed at. She also highlighted that even though clearing and margin requirements are yet to be adopted, firms are already preparing to implement these requirements and that therefore panellists were welcome to exchange views and their experience in particular on access to clearing.

Mireille Dyrberg explained that post-trade risk reduction services address risks that are not addressed by central clearing. She made a plea for the creation of a regulatory framework for the appropriate treatment of post-trade risk reduction services for OTC derivatives other than portfolio compression. Other post-trade risk reduction services address risks such as counterparty risk, portfolio risk and basis risk. A horizontal approach under EU Law in this area would allow innovation in these post-trade risk reduction services which makes the market safer and more transparent.

Marieke van Berkel addressed two issues:

- Access to central clearing: she indicated that smaller participants, in particular cooperative banks and building societies, have difficulties getting access to clearing as indirect clearing services are not developing and clearing members that could offer clear on behalf of smaller counterparties seem to be withdrawing from the market. She also indicated that the costs of those services that are available are prohibitive as they are disproportionate to the business of smaller players who need to use derivatives to cover relatively simple but important retail financial products.. She raised the question of whether an exemption from central clearing for small financial counterparties entering into certain types of transactions should be considered.
- Account segregation: the obligation for clearing members to offer individually segregated accounts to clients is not suited to the retail market. Retail clients do not generate enough business to justify the cost of maintaining these accounts.

Simon Puleston Jones covered three topics:

- Access to clearing: Impediments to client clearing exist. Many clearing brokers are turning away business due to capital and leverage ratio constraints under CRD IV. Being of insufficiently strong credit quality is another impediment. This leaves indirect clearing which raises issues linked to the leapfrog payment and the lack of clarity of the jurisdictional scope of these provisions. Alongside the lack of scalable solutions, this impedes the offering of indirect services that are EMIR-compliant. Changes to CRD IV and EMIR should therefore be considered.

- Clearing mandate: he noted that it must be ensured that only products suitable for clearing are cleared by a CCP. He indicated that there might be a need to allow for the temporary suspension of the clearing obligation in certain stressed circumstances, e.g. a drying up of liquidity. He asked for the removal of frontloading, the offering of omnibus segregated account as a default choice for clients which do not confirm their choice of segregation in line with the conditions of Article 39(5); and the exclusion of portfolio compression trades from the clearing obligation.
- Global context: he explained that the obligation on US clearing memberss that are clearing members of EU CCPs to offer individually segregated accounts was not compatible with relevant US bankruptcy rules. He asked for the completion of equivalence decisions pursuant to Article 13 of EMIR and Article 19.6 of MiFID which has implications for calculation of the clearing threshold by NFCs, and the recognition decisions for non-EU CCPs under Article 25 of EMIR.

Patrice Aguesse noted that the AMF has seen evidence that risk mitigation techniques have led to product standardisation and legal certainty. With regard to the clearing obligation, he explained that some counterparties have started to implement necessary requirements and have already raised some challenges (notably updating contracts, technological developments and choice of account segregation type). As to the offering of different segregation models, he indicated that:

- Offerings in the EU are not limited to individual and omnibus accounts, and other possibilities are offered to clients;
- The buy-side will have to choose between more protection (individually segregated accounts) and lower cost (omnibus segregated accounts);
- Portability was more feasible for individually segregated accounts.

Q&As

Several participants representing smaller financial counterparties echoed some of the comments made by panellists and asked whether the EMIR requirements (clearing/margins/reporting) should continue to apply to all financial counterparties regardless of their size and of the systemic risk they represent or whether a carve-out should be envisaged for all non-systemically important firms and not just non-financials.

5. Panel 4 - Trade Reporting and Trade Repositories

Moderator:	**Jochem Kimman**, The Netherlands Authority for the Financial Markets (AFM)
Panellists:	**Andrew Harvey**, Managing Director – Europe, Association for Financial Markets in Europe (AFME)
	Erich Schaffer, Managing Director, Securities Supervision, Austrian Financial Market Authority
	Adam Jacobs, Director, Head of Markets Regulation, The Alternative Investment Management Association
	Mari Carmen Mochón, Head of Institutional Relations, REGIS-TR

The moderator shared the view that the objective of transparency is being achieved: regulators and supervisors are systematically using the data available in trade repositories. Although data quality is improving over time, further enhancements are needed, in particular as regards unique product and trade identifiers. Market best practices could help in this area. The moderator acknowledged challenges with dual-sided reporting but noted that this can ultimately significantly improve data quality.

Andrew Harvey set out three key issues affecting reporting requirements:

- Whether reporting requirements should be dual-sided or single-sided;
- The need for a globally-applicable, explicitly defined common data set
- The need for global agreement on what type of data should be reported and when.

He shared the view that known issues with dual-sided reporting impede data harmonisation and further agreed with the moderator's view that common unique product and trade identifiers must be agreed upon. Mandatory use of legal entity identifiers and harmonisation of timetables for requirements globally could also enhance implementation of trade reporting requirements.

Erich Schaffer shared the view that data quality is crucial and that mechanisms are needed to aggregate data across different trade repositories, noting different approaches across different trade repositories to implementing reporting. He suggested that soft measures such as Q&As could help to narrow discrepancies in data reported.

Adam Jacobs shared the view that dual-sided reporting is not working well, and supported a move to single-sided reporting with a clear hierarchy of which party should report. This could be based on existing regulatory definitions. He also noted the importance of regulators having access to comprehensive and detailed data, and the need to avoid fragmentation of data across different trade repositories.

Mari Carmen Mochón noted that, from the perspective of a trade repository, there was less delegation of reporting by NFCs than expected. This resulted in a high multiplication of connectivity between trade repositories and users. She agreed that data quality needs to be further improved with a focus on a common unique product and trade identifiers. However, she noted that these processes of data improvement need time – a learning curve must be accepted and existing developments must be leveraged.

<u>Q&As</u>

The majority of questions focused on the issue of dual versus single-sided reporting, with reference to data quality and mismatched trades. Some participants from the financial sector showed support for a move towards single-sided reporting. One participant representing a trade repository noted that dual-sided reporting theoretically resulted in a higher quality of data, but that this was dependent on agreeing on the data format. Two participants from infrastructures suggested that other means were used to mitigate discrepancies, such as trade confirmation or affirmation processes which may occur before the trade is reported. Participants also raised the question of whether significant changes to trade reporting requirements would be cost effective at this stage, considering the investments already made by market participants to comply with the existing framework. Other questions included whether longer reporting timeframes could help improve data quality and difficulties with the reporting of exchange traded derivatives.

6. CLOSING REMARKS

The closing statement was made by Jonathan Faull, Director-General of DG FISMA. Mr Faull thanked the participants for the high quality of the discussion. He said that much has already been done despite a number of challenges, but that the issues raised at the hearing show that there had been some implementation "teething problems" and that several important pieces of the puzzle still need to be put into place. He suggested that there are currently two types of challenges: those which are already known (such as the need to ensure the quality of reporting to trade repositories and the need for client clearing solutions) and those which remain to be discovered as further requirements begin to be implemented – and which by their very nature will be more difficult to address. Mr Faull concluded by urging all participants to contribute to the public consultation in order to help identify any issues and to find the most appropriate solutions to all of the challenges.

Mr Faull's speech is available at: http://ec.europa.eu/finance/events/2015/0529-emir-revision/index_en.htm