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EBF response to joint-ESAs consultation paper on Draft RTS on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) EMIR

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

- Alternative processes to post collateral (Recital 8)

Recital 8 of the draft RTS addresses the issue that the legal enforceability of the collateral segregation arrangements may not be sufficiently certain under the legal framework of a certain jurisdiction. According to this recital, the addressees of the obligations would be obligated to identify alternative processes to post collateral under these circumstances. The recital itself mentions the possibility to rely on third parties situated in another "safe" jurisdiction. In the public hearing, the possibility to elect the application of the laws of another jurisdictions was mentioned as a further example. In addition, it was further explained that more specific provisions had not been included intentionally in order to give the market participants some flexibility to implement alternative processes. We of course welcome this approach and indeed believe that market participants will need some discretion in order to address any unforeseeable legal challenges which they may face when trying to implement collateralisation arrangements in various jurisdictions, in particular third country jurisdictions.

However, this necessary room for discretion is currently only addressed in the form of a recital and is not reflected in any way in the regulatory provisions as such. To ensure that the market participants indeed retain some flexibility in devising alternative approaches, it would be helpful if the possibility were also addressed in the provisions themselves. This should include, but not be limited to, the possibility to deviate to some extent from the reciprocal (two-sided) nature of the obligation by only collecting or posting collateral unilaterally.

Such further discretion to deviate from reciprocal collateralisation and segregation will specifically be required in relation to transactions with counterparties based in jurisdictions where effective segregation of collateral cannot be ascertained and netting agreements are not (or not sufficiently) legally protected or recognised under applicable insolvency law. Here, the involvement of third party custodians situated in a netting and segregation supporting jurisdiction and/or the election of the laws and courts of such jurisdiction lone may not

sufficiently safeguard the effectiveness of netting and segregation agreements in the case of an insolvency and an exchange of collateral may actually increase the risk exposure of the posting party rather than reducing it.

In such circumstances, alternative approaches will need to be permissible which go beyond the involvement of third parties and election of the laws and courts of supportive jurisdictions. Such further alternative approaches should include (without intending to limit the choice of other, effective alternatives)

- Reliance on third party guarantees securing the obligations of the relevant counterparty
- The introduction of a threshold amount for uncollateralised transactions for specific circumstances/jurisdictions/markets.

When it comes to posting margin to counterparties in non-netting jurisdictions (whether third countries or EU, as the case may be), it may not be feasible to find satisfactory alternative arrangements (other than through the gross based capital charges). Since the requirement to post margin could increase the systemic risk in the transactions with counterparties located in jurisdictions where the close-out netting is not enforceable, EBF would recommend to remove the obligation to post collateral in the context of transactions entered into with counterparties domiciled in jurisdictions in which the close-out netting would not be enforceable upon insolvency of a local party or where it is not possible to guarantee the effectiveness of the segregation agreements.

- Treatment of non-EU non-financial counterparties (Art. 2 GEN):

The EBF welcomes the equality of treatment to ensure level playing fields internationally, and in particular the ESAs proposal to exclude from the EMIR margin rules non-EU entities that if based in the EU would be non-financial counterparties.
The EBF would also seek clarifications about the exact treatment of non-EU sovereigns and specifically whether they will benefit from the same exemptions than the ones for EU sovereigns. We note that the proposed Article 3 GEN seems to be flexible enough to consider this issue however we would appreciate if the ESAs could expressly indicate what the applicable regime in such a case is.

- Exchange of margins with third country entities (Art. 3 GEN):

The draft RTS requires posting margins to the third country counterparties, whether the third country is willing or able to receive the collateral assets in a way compliant with the EU regulations. As a result, when trading with EU counterparties, third country entities would not only face a higher transaction cost which is already created by the obligation to post margin to the EU based counterparty, they would furthermore face an infrastructure cost associated with the collection of margin in a way that fully complies with the EU regulations. Such third country entities may not be willing to engage heavy resources to comply with the regulation which is not imposed by their home regulator. As a result, they may stop trading with the EU counterparties, therefore third country entities should not be obliged to collect margin from their EU counterparties.

- Definitions (Art. 2 GEN)

Art. 2 GEN uses the term “non-financial entity” in this context (distinguishing between third country-counterparties which are “financial entities” or “non-financial entities” equivalent to NFC+ on the one hand and “non-financial entities” which are not equivalent to NFC+). The term “financial entity” presumably is intended to capture entities which are equivalent to FCs as defined under EMIR. However, term is currently undefined, which may lead to uncertainties. It could therefore be considered to incorporate a definition of “financial entity” or even third country financial entity as well as non-financial entity.

Although this follows from the context and the underlying objectives of EMIR it could also be considered in this connection to include a clarification to the effect that the obligations also need not be applied in relation to counterparties which do not even qualify as NFC (such as non-undertakings or counterparties falling within the scope of Art. 1 (4) and (5) EMIR or equivalent thereto).

- Procedural character of the obligations (no formal opt-out agreements) – Art. 1 GEN and Art. 2 to 4 GEN

We further welcome the fact that the revised draft RTS now underline the procedural character of the obligations, and, as one consequence thereof, no longer require the entering into formal agreements with each counterparty, even those not qualifying as FC or NFC+ (and equivalent third country counterparties), in order to be able to rely on existing exemptions from collecting and exchanging variation and initial margin. This approach to describe the obligations primarily as procedural without detailed formal requirements ensures that it will not be necessary to approach every single market participant with the sole purpose of formally agreeing on an opt-out from collateralisation (and the connected contractual documentation). This significantly reduces the burden for the addressees of the obligations as well of the numerous market participants which are not intended to be captured by the margin requirements.

- European counterparties have the obligation to assess the legal enforceability of the netting and segregation agreements

We understand the need for legally effective and enforceable netting and segregation arrangements. We welcome that the original requirement for the legal opinion on effectiveness of the IM segregation has been replaced by a less cumbersome requirement of an internal legal review.

Indeed, EBF considers that the requirement to post margin could increase the systemic risk in the transactions with counterparties located in jurisdictions where the close-out netting is not enforceable and would recommend to remove the obligation to post collateral in the context of transactions entered into with counterparties domiciled in jurisdictions in which the close-out netting would not be enforceable upon insolvency of a local party or where it is not possible to guarantee the effectiveness of the segregation agreements.

- Foreign Exchange Contracts (Art. 5 GEN)

Art. 5 (c) GEN including recital 17 demanding that cross-currency swaps is split up and only the FX forward is part of the exemption seems unpractical because currency swaps is registered as one transaction.

- Threshold based on initial margin amount (Art. 6 GEN)

Uncleared OTC derivatives between members of the same group should not be included in the calculation of the IM phase-in threshold. This is consistent with the application of the EUR 50m IM threshold between consolidated groups. If not, there is a double-counting effect for back-to-back transactions to transfer market risk to the group member who holds the market making book and/or who contracts with external parties. This may cause a group to exceed an IM phase-in threshold when such back-to-back trading does not really represent incremental systemic risk.

The EUR 50m threshold set out is to be calculated between counterparties at a group level. We suggest introducing a possibility to exclude some group entities, which are financial counterparties, e.g. life insurance companies, pension funds or asset managers, which would make the calculation of the threshold less complicated.

The margin requirements should not apply to legacy uncleared OTC derivatives that are transferred to an EU entity where such transfer is to comply with systems similar to the one proposed under the EU Bank Structural Reform regulation. This would increase the burden on EU entities subject to EU Bank Structural Reform regulations to fund margin collateral as a consequence of such entities complying with EU member state requirements, when such arrangements could necessarily be viewed as reducing incremental systemic risk (as opposed to increasing it). This may also cause a group to exceed any IM phase-in threshold when that group is merely complying with its wider EU obligations.

The derivatives cleared on voluntary basis i.e. in absence of mandate, should not be counted toward the IM phase-in threshold. This could be clarified for the avoidance of doubt.

- Treatment of derivatives associated to covered bonds swaps for hedging purposes (Art. 8 GEN)

We suggest removing the requirement for covered bond issuers/cover pools to collect VM (and for counterparties of the third-country covered bond issuers to post VM). In many jurisdictions, covered bonds issuers are not currently collecting VM in practice, although in theory the collateral arrangements are in place and can be triggered upon occurrence of certain events. The current approved standard for covered bonds linked collateral agreements provides for high thresholds and downgrading triggers which in some cases give rise to the transfers of collateral. A new structure which would require collecting VM without thresholds may have a negative effect on the covered bond activity in general. Covered bonds issuers would have to build an infrastructure to allow collecting and maintaining the variation margin in a way compliant with the regulations, including the eligibility criteria monitoring etc. The cost of hedging the covered bonds would significantly increase, as the hedging counterparties are not

currently posting collateral in vast majority of cases. The requirement for the hedging counterparties to post VM to their covered bond counterparties without application of the industry standard thresholds and rating triggers would have a major effect on pricing and thus a negative knock on effect on the covered bond issues in general. In line with the objectives of the EMIR regulation, the margining rules should address the systemic risks in the flow OTC derivatives market where a regulatory framework have not already provided for satisfactory safety net from the risk management perspective. In parallel, the new requirements should preserve the existing well-functioning structures with clear benefit for the financial markets and the economy as a whole. The covered bond framework is a regulated one and already subject to thorough scrutiny of the rating agencies. Therefore, it does not seem to be a natural focus of this margining regulation.

- Provisions concerning the covered bonds (pages 30 and 31)

EBF welcomes the ESAs' proposed treatment of derivatives associated to covered bonds for hedging purposes. Indeed, the proposed wording of Article 8 GEN (2) (b) ensures the exemption from margin requirements (i) where the counterparty to the OTC derivative contract ranks at least pari-passu with the covered bond holders and also (ii) where such counterparty does not rank pari-passu with said covered bond holders because it is either the "defaulting" party or the "affected" party.

This EBF's request was linked to the "flip clause", applicable for both SFH and SCF covered bonds programs. Our purpose was to mirror the clause included in the covered bonds documentation and which refers to the cases where the derivatives counterparty is the "defaulting" or the "affected party". This clause triggers the loss of the senior rank of the derivatives counterparty in the payment priority order of the privileged creditors.

However, not all covered bond programs have flip clauses and it is not a requirement in all covered bond legislations to have such. It is therefore essential that Article 8 GEN (2) (b) is not constructed so as to require flip clauses (it shall only provide for that possibility). In our view the proposed wording of Article 8 GEN (2) (b) is not clear in this respect and we therefore propose that it is formulated as follows:

"[…] (b) The counterparty to the OTC derivative contract ranks at least pari passu with the covered bond holders, except that a more junior ranking is permitted where the counterparty to the OTC derivative concluded with covered bond issuers or with cover pools for covered bonds is the defaulting or the affected party".

The clearing and other risk management procedures in EMIR and in the EU delegated legislation issued under EMIR (such as the draft RTS) only applies to derivative transactions which involve two or more counterparties. Hence, the rules do not apply with respect to derivatives transactions entered into within the same legal entity (see EMSA's response to TR Question 14 in the EMIR Q&A). If , in accordance with national legislation and upon prior approval by its competent authority, a bank issues covered bond issues, all such hedging arrangements are made within the same legal entity. It would be both desirable and advantageous to clarify that the RTS does not apply to such internal hedging transactions.

- Scope

It is crucial to avoid any major disruption of competition for banks subject to EMIR and for their clients and to ensure a level playing field between all markets participants involved in the global OTC derivative market. Any material divergence between the European framework and other regimes will increase market fragmentation, reduce market depth and liquidity and increase the price dispersions. In this context, the EBF considers that harmonisation is still needed, notably in the scope of financial instruments. Indeed, the scope of instruments covered by EMIR is wider than in the US where neither variation margin nor initial margin is required for physically-settled FX forwards and swaps in US and where instruments such as equity options and derivatives on equity indices are neither considered as "swaps" nor as "security based swaps" under the 'Dodd-Frank Act' and hence are not subject to the margin requirements set out by BCBS-IOSCO. Consequently, EU firms may be rejected from third country markets if they have to collect initial margins on these instruments while other banks do not.

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

- **Definition of variation margin (Art. 1 (5) GEN)**

The definition of variation margin (VM) refers to "outstanding contracts" and does not mention the fact that the positions may be covered by a netting agreement and thus combined to a single net position. Although this follows from context and the fact that netting agreements are expressly addressed in other provisions, it may be considered to clarify this in the definition as well.

- **T+1 requirement IM (Art. 1 (3) EIM)**

In the case the proposed timing would be imposed for the complete collection of margin, we think that this would be operationally unfeasible. Even for cash, market practice is as such that calculation could be performed in T and the call could be made in T+1 which would mean that the collateral would generally move not before T+2.

Consequently, the EBF reiterates its request to ensure the consistency of the timing imposed for calling and collecting initial and variation margins with the standard settlement/delivery regimes applicable to eligible collateral assets (i.e. broadly between one and three business days) with daily calculation and margin calls. This timeline enables a sound management of operational risk. This slight extension of the time-line would greatly reduce operational burden and associated operational risks.

An extended settlement period of T+3 would also help to address to some extent the considerable new complexities which will be introduced by the future RTS and which will further prolong the settlement process, such as the calculation of the MTA on group level as well as concentration limits. In addition the location of the parties and time zones in which they operate will need to be taken in consideration in this context: a cut-off time should be allowed to reflect the time zone differences between the parties´ respective locations.

At the very least it should be clarified that any breaches of the T+1 requirement where these are not caused by the party in question (that is where the causes are outside of its sphere, e.g. caused by the central securities depository) are not automatically deemed to constitute a breach of regulatory requirements.

- **T+1 requirement VM (Art. 1 VM)**

The above concerns apply correspondingly to the equally strict time limit (T+1) for exchanges of VM where no IM is being exchanged. As mentioned above, the time restrictions will be extremely challenging even in the case of cash collateral. They are impossible to observe in case of securities. The time limits for an exchange of VM should neither result in operationally challenging requirements nor should they effectively reduces usage of non-cash collateral for variation margin (mostly for the smaller entities solely exchanging variation margin)

Regarding the wording used in relation to the collection of variation margins, we would like to point out that the phrase "settling exposures in cash" in Art. 1 VM (2)(a) should be replaced with the phrase "exchanging cash in amounts sufficient to extinguish exposures". The current language is not a correct general description of variation margins transfers for OTC derivatives because the transfer of cash variation margins does not necessarily settle current exposure. This change should also be reflected in Recital 11 (p.19).

- Settlement timeline

The distinction between the IM and VM settlement timelines disadvantages the smaller entities posting only variation margin and creates an uneven playing field with the bigger market participants. The distinction is not sensible from the operational perspective, since the smaller entities do not have the same infrastructure and liquidity as their bigger peers while facing shorter settlement deadlines. Also, the requirement discriminates the asset classes which may not be settled within 1 business day (such as Japanese government bonds or Yen cash).

It should also be recognised that certain entities may be restricted in what collateral type they can accept (by regulations, local market practices, internal policies etc.). Meeting the T+1 settlement deadline can then be challenging for their counterparties without much alternative collateral types to choose from. The liquidity issue has been taken into account when it comes to the concentration limits applicable to the governments bonds (where small non-systemically important institution where exempted). A consistent approach would be welcome here too.

- Application of the MTA when calculating VM and IM – Art. 4 (2) and (3) GEN

Recital 10 addresses the possibility that counterparties split the minimum transfer amount (MTA) in two separate amounts for VM and IM, respectively (the total of which not exceeding the prescribed maximum of 500.000 €). The provisions setting out the manner in which the amounts due are to be calculated when applying the MTA do, however, can be read to preclude a direct application of such a split MTA on the level of the VM and IM amounts since they appear to foresee an application of the MTA only after calculation of the IM and VM amounts., calculated in accordance with Art. 4 (2) (a) and (b) GEN. It should therefore be clarified that that in the case of a split MTA, these can be applied already directly on IM and VM level, that is when calculating the IM and VM amounts in accordance with Art. 4 (2) (a) and (b) GEN.
The authorised MTA may be subject to the currency fluctuations if the Base Currency is other than EUR. This seems to be a challenge for collateral management systems. The currency effects should be allowed to the extent the MTA was in line with the maximum authorised cap at the time the agreement was entered into between the parties.

- Application of group IM threshold – Art. 6 GEN

The provisions regarding the application of the threshold on group level do not clearly set out that this threshold is to be applied in relation to the own group and not the group of the counterparty, that is, each group is responsible for monitoring its overall exposure to a specific counterparty and have procedures in place in order to ascertain that the own group members observe the group threshold when entering into transactions with this specific counterparty. This could be clarified in a recital to avoid confusion.

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

- Calibration of the model (Art. 3 MRM)

Regarding the Article 3 MRM, the EBF would welcome clarity on the definition of "a period of significant financial stress" and how this will be interpreted in practice.

The EBF welcomes the confirmation by the ESAs that counterparties will be entitled to use internal initial margin models. The EBF also welcomes the greater flexibility granted by the ESAs on some issues, and notably the consent by the ESAs to a follow-up validation of initial margin models on a yearly basis (unless significant changes within this time-period) and not twice a year.

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

The RTS states that initial margin models should be based on an asset-class comparison (i.e. a comparison with OTC derivatives that are in the same "netting set" and within the same "underlying asset class" as defined in the draft RTS). However some banks consider that initial margin models should be determined on a risk-based approach (i.e. via a classification by type and degree of risk), as the latter criterion appears to be more consistent with the calculation of appropriate initial margins.

The assessment of the liquidity of the derivative contracts portfolio (required in order to assess the validity of initial margin models) may raise various issues: (i) the estimation of such liquidity is very problematic as the liquidity may evolve and does not rely on standardised predetermined criteria, (ii) the assessment of the liquidity will imply operational constraints for banks as the latter will define sub-categories of derivative contracts portfolios and calculate separate and specific initial margins for transactions concerning each of these sub-categories, and (iii) this sub-categorisation of portfolios may lead to an increase of the global initial margins to be posted/collected (securing each sub-category of derivative contracts portfolios may be more costly for each counterparty than securing a global derivative contracts portfolio).

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

- Concentration limits (Art. 7 LEC)

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

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

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

One potential consequence of an overly punitive treatment (e.g. the maximum contribution from any one issuer set to 10% of the total collateral value), combined with a shortage of other equivalent assets, would be that other lower quality and less liquid assets could be posted as collateral, i.e. an overall collateral "downgrade", increasing risks for counterparties. We would therefore propose that under EMIR that covered/mortgage bonds receive similar treatment as government bonds, i.e. to have no concentration limits or that the maximum concentration limit is raised considerably.

We welcome the exemption for government and municipal bonds but this requires yet another monitoring procedure of own/counterparty´s SSI status and IM levels. The principle of proportionality (i.e. to avoid too cumbersome obligation given the limited regulatory benefit) seems to require that the criteria for the exemption is based on an existing categorisation or data already imposed to be exchanged otherwise (such as IM trigger). If this monitoring would be too cumbersome, parties will be discouraged from posting high quality collateral.

For consistency with the application of the concentration limits, the threshold in paragraph 3(c) shall be applicable at the individual counterparty entity level and not at group basis.

We note that the mechanism through which the SSI status will be monitored and published has not yet been implemented by the authorities. It may therefore be potentially difficult to monitor at the moment.

We would like to propose raising the EUR 1 billion of collected collateral threshold. For smaller institutions, a handful of relationship which may reach this level would drag then into the cumbersome monitoring procedures and systems solutions. Alternatively, we would suggest a general exemption from the proposed concentration limits for counterparties with low exposure, posting less than EUR 100 million.

The 1 billion euro threshold raises some specific issues: The calculation modalities of the 1 billion euro threshold should be clarified: shall this threshold be calculated individually (i.e. by netting set as specified during the EBA's public hearing) or globally (i.e. taking into account all the collateral exchanged with all the counterparties of the bank)? The second option seems more consistent with the purpose of the regulation – and would be more practicable from an operational viewpoint.

The calculation period of the 1 billion euro threshold should also be clarified: shall it be calculated on a daily basis or over a specified time-period? The second option would be more practicable from an operational viewpoint.

The monitoring of concentration limits with respect to the IM segregated at a third party custodian presumes that the custodians will assist with the monitoring.

Although the ESAs noted the intention to align with the international standards, the requirement to monitor the concentration limits and wrong way risk of the collected collateral remains at odds with the US margining regime.

The ESAs should also clarify the consequences of a potential evolution of the amount of the collateral exchanged with counterparties just above or just under the said 1 billion euro threshold, notably in cases where this evolution takes place within the timeframe of the threshold calculation period.

Regarding the need for entities which are not qualified as G-SIIs and may not diversify their collateral offered, the EBF also recalls that such proposal will require from the banks to categorise their clients into tiers (a tier 1 covering clients benefiting of the exemption mentioned, and a tier 2 covering the non-exempted clients), which would impose a significant operational burden for the banks.

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

We welcome the ESAs proposal in not placing an undue burden on FCs and NFC+s in order to obtain a written agreement with all counterparties, including NFC-s. This will reduce the unnecessary documentation and operation burden on banks dealing uncleared OTC derivatives with corporates. FCs and NFC+s can then focus on their preparation and compliance efforts on transactions that are in scope of the BCBS-IOSCO framework i.e. uncleared OTC derivatives with and between FCs and NFC+s.

The requirement for the legal analysis of the netting arrangements is new, introduced in the second consultation alongside the original requirement for analysis of the validity of segregation arrangements. However, we believe that the requirement with respect to netting is already satisfactorily addressed through the capital adequacy framework as precondition for netting benefit under the Article 296 of Regulation (EU) No 575/2013. The RTS shall not introduce a supplementary legal review process which is not fully consistent with the capital adequacy framework process.

We understand the relevance of analysis of validity and enforceability of the netting arrangements. In some jurisdictions however, including the EU Member States, a clean netting opinion cannot be obtained. The status cannot be remedied unless the local bankruptcy legislation is amended to recognize the close-out netting arrangements upon opening of insolvency proceedings of the local counterparties.

We refer to our response on Q1 regarding the need to permit alternative approaches in the case a local jurisdiction does not support netting.

We further welcome the clarification made in the Public Hearing that the term "independent" is to be interpreted in accordance with the EBA response to Question No. 2013_23 in the Single Rulebook Q&A process; thus including provision of qualified internal legal advice, i.e. from the legal department of the institution.

The changes and clarifications made provide for the necessary degree of flexibility regarding the manner in which a legal review process can be implemented as part of and under the existing risk management systems and procedures of a counterparty. For example, we assume that the independent legal review requirement can been deemed to have been met, where a counterparty has procedures in place which provide for a monitoring / regular assessment whether there have been any material changes in the relevant laws which may have adversely affected the enforceability and validity of the contractual arrangements used, and where such material changes then trigger further steps which may include, for example, the obtaining

The requirement to conduct the legal review annually is still cumbersome and perhaps not feasible with current legal resources available to the participants in-house. The operational and cost implications are therefore significant. We would suggest aligning the frequency of the review to the position of the Article 296 of Regulation (EU) No 575/2013 leaving the assessment to the internal policies on "if and when required" basis.

EBF considers that such requirement could increase the systemic risk in the transactions with counterparties located in jurisdictions where the close-out netting is not enforceable and would recommend to remove the obligation to post collateral in the context of transactions entered into with counterparties domiciled in jurisdictions in which the close-out netting would not be enforceable upon insolvency of a local party or where it is not possible to guarantee the effectiveness of the segregation agreements.

In Article 2 OPD – Trading Documentation, page 47, clause 1.d. clarification and definition is needed for the term "calculation methods".

- Written trading documentation (Art. 2 (1) OPD)

The term "trading documentation" is open to interpretation. We assume that this is intended to cover the contractual documentation setting out the general legal basis for the transactions to be concluded, namely the general framework for the margin requirements (including supplemental agreement) as well any netting agreement, but does not include the trade confirmation with the commercial details and sometimes further specific terms governing the specific transactions. This would reflect the established market practice of relying on standardised contractual agreements which address the general framework and key provisions (such as netting provisions and collateral annexes) and the use of trade confirmations to determine further details. The general framework (master agreement and collateral annex) is generally entered into in advance or on the conclusion of a transaction whereas the trade confirmations, by their nature, are issued subsequently following the agreement on the specific terms (which agreement can occur many forms, including by telephone). Consequently, a clear distinction has to be drawn between the general contractual framework which has to be in place in advance of or at the time of the conclusion of the transaction on the one hand and the trade confirmation which may cover additional terms but may only be formally documented following the agreement on a transaction on the other.

The use of the word "any" in Art. 2 (1) (a) OPD can be understood to mean that the relevant contractual documentation needs to include provisions which cover every possible payment obligation which may arise under or in relation to a transaction and/or contractual relationship. Such an understanding would be incorrect since contractual documentation intends or is able to specify or cover all possible payment obligations which emanate or may emanate from a contractual relationship. In addition, this understanding would conflict with the above described situation that certain transaction specific terms including payments may be agreed and documented in the trade confirmation, and thus not already in advance of a transaction. The contractual documentation will only be able to cover the general or material terms and the general basis for the rights and obligations but not any and all rights and obligations. The term "any" should therefore be deleted. The above applies correspondingly to the use of the term "any" in Art. 2 (1) (e).

The use of the term "written" in this context can be understood to preclude electronic messages and means of recording/documenting. It should therefore either be deleted or replaced by a term with a broader meaning covering any form which ensures an adequate recording/documentation, including electronic records.

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

- Independent legal review requirement (Art. 1 (5) SEG)

The concerns already raised above in our response to Question 5 regarding the legal review requirement (repeated here for the sake of convenience) apply correspondingly. We would like to raise the same concerns with respect to the performance of the annual independent legal review as in Question 5 above.

- Segregation of initial margins (Art. 1 SEG)

The introduction of the new requirement for the IM to be protected from the default or insolvency of the "third party holder or custodian" amounts to in practice prohibit posting of cash as IM. Indeed, of the cash is inherently linked to the solvency of the third party bank/custodian account holder. In line with the Art. 1 REU, the cash will only be permissible as initial margin if it is re-invested. The consequential prohibition of initial margin in cash unless it is transformed into an alternative asset is too restrictive as cash was expressly envisaged by the BCBS-IOSCO framework for margin requirements for non-centrally cleared derivatives as a major liquidity safety net where securities are not available (distressed markets).

The Art. 1 SEG seems to describe only a model of third party segregation at the level of the collecting party (i.e. held segregated in the name of the collecting party). However, it does not expressly envisage segregation on an account at a third party banks in the name of the posting party that is charged in favour of the collecting party. Indeed, the second model does not involve segregation from proprietary assets of collecting party described and required in Art. 1 SEG (1) to (2). It seems even prohibited by the Art. 2 LEC (d) whereby the cash IM shall be maintained with a party other than collateral provider. This second model is however one of the segregation models in development which is expected to be used in most cases by the market participants.

In that context, in accordance with the BCBS-IOSCO recommendations, it should be made clear that in addition to the third-party holder or custodian initial margins could be collected by the collecting counterparty provided that the latter complies with the requirements of Articles 1 LEC and 1 SEG. We think that the first paragraph of Article 1 SEG does not provide enough clarity. In light of the above we suggest that "collateral collected as initial margin shall be segregated from proprietary assets on the books and records of the collecting counterparty, a third party holder or custodian, or via other legally binding arrangements made by the collecting counterparty to protect the initial margin from the default or insolvency of the collecting counterparty, third party holder or custodian."

Finally we believe the requirement for re-investment of cash IM, if maintained, shall exempt the "incidental cash" such as distributions, redemptions and other cash generated by the re-investment).

- **Relation between segregation requirements and collateral management requirements (Art. 1 SEG and Art. 2 LEC)**

Art. 2 LEC appears to address some aspect which are also covered by the segregation requirements. One example is the requirement under Art. 2 (1) (c) LEC regarding insolvency or bankruptcy remoteness of initial margin maintained with the collateral provider. It is not entirely clear how these obligations covering similar or connected questions are to interact or which requirements prevail in the case of conflict. In particular all requirements addressing insolvency/bankruptcy remoteness need to be coordinated to avoid discrepancies or uncertainties. To this end, these should only be covered by one single provision.

- **Assessment of the effectiveness of the netting and segregation agreements**

As to the need to for alternative approaches and deviations from the obligation to exchange collateral in the case that segregation agreement and/or netting agreements are not sufficiently protected and supported by the laws of a third country, see our comments regarding this issue in our response to Q1 and Q5 above.

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

- Re-investment of cash initial margin (Art. 1 REU (2))

The reinvestment solution in Article 1 REU (2) may not be workable from a practical/commercial perspective. It presumes existing of a framework whereby the custodians would conduct the reinvestment according to the strategy agreed with the parties and moreover in compliance with the credit quality and concentration limits requirements does not currently exists. This therefore does not seem satisfactory to facilitate the usage of cash as IM to the extent it cannot be posted without being re-invested.

The proposal is also too restrictive for other reasons. Indeed, the cash re-used must be reinvested "only for the purpose of protecting the collateral poster" in case of default of the collateral beneficiary. For such purpose, ESAs specify that the cash used must be reinvested in securities and that the latter have to be segregated and not re-used. This restricted discretion granted to the collateral beneficiary may challenge the interest of such re-use while a huge portion of the collateral will be posted in cash.

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

It should be possible to include the FX volatility in the initial margin calculation instead of using a standard haircut. Further, we would ask the ESAs to provide clarity on the meaning of the term “transfer currency”, and “termination currency”. Does it mean base currency and close out currency?

The EBF welcomes that no FX haircut will apply where VM is posted in cash. However, the FX haircuts applicable in all other cases creates prohibitive cost or alternatively an important operational burden on the collateral management should the collateral be posted in currency silos. We support the previous request to replace 8% haircut entirely and include currency mismatches in the IM model for those parties that collect IM.

Regarding FX currency mismatch it is inconsistent that the RTS exempt physically settled FX derivatives from the IM requirements in Art. 5 GEN, but at the same time introduce an 8% haircut as mentioned in paragraph 6 and 7 on page 57. Haircut addresses potential future loss on the value of the collateral. Given that the majority of the risk in a transaction typically is constituted by the FX transaction, it seems unnecessary to introduce haircut on collateral. Furthermore, the haircut of 8% ought to be lower for currency pairs with low volatility, e.g. when one currency is pegged to another.

Other issues:

1. Intragroup exemption (pages 51 and 52)

Granting of intragroup exemptions is extremely vital to many European banks and entities with intragroup transactions. The current text is a significant improvement from the previous version where in principle existence of any insolvency law would have fulfilled the definition of legal impediment.

There are additional criteria on the condition referred to in Article 11(6) of EMIR under which the intragroup exemption is granted provided that "there is no practical or legal impediment to the transfer of own funds or repayment of liabilities between the counterparties". It is not clear at all how competent authorities will apply them and in fine will grant such exemption. In particular, we consider that it is necessary that further guidance is provided as to what type of legal or regulatory restrictions that are "in scope" to constitute restrictions that would prevent intragroup transactions from being exempted. In view of the general nature of Articles 2-4 IGT we believe that it could be useful in the future to have further guidance on these matters and to ensure that the criteria for granting exemptions are applied consistently across the member states. We note in this context that similar questions arise under CRR Article 8.1(d) and in relation to that provision the Commission has issued a report ("Legal Obstacles to the Free Movement of Funds between Institutions within a Single Liquidity Sub-Group") addressing certain specific potential legal obstacles and their relevance under CRR Article 8. We consider that similar guidance is required in relation to Article 11(5) to (10) of EMIR.

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

We also highlight that under EMIR, intragroup transactions only benefit from the exemption from Art. 11(3) where the conditions in Art. 3 and Art. 11(5) to (10) are met. ESMA's questions and answers on the implementation of EMIR make clear that the intragroup exemption is not available for transactions between an FC or NFC+ and a counterparty established in a non-EU country unless and until the Commission has adopted an implementing act on equivalence in relation to that non-EU jurisdiction under Art. 13(2) of EMIR.

There have been considerable delays in finalizing the equivalence assessments under Art. 13(2) of EMIR even in relation to the initial group of non-EU countries on which ESMA has already delivered technical advice to the Commission. It is also clear that it will be some time before such an equivalence assessment can be adopted by the Commission for many countries as this will be dependent on their rate of progress in implementing the G20 derivatives agenda.

In addition, it is currently unclear whether equivalence assessments under Art. 13(2) of EMIR will include provisions for partial or conditional determinations of equivalence as envisaged by ESMA's advice and whether or how any such determinations will affect the intragroup

exemption. Counterparties will need additional time to adjust to any additional requirements imposed as a result.
We are therefore very concerned that only intragroup transactions between group entities located within the boundaries of the EU will qualify for the definition of intragroup transactions by the time these standards are being applied, as no such implementing acts will have been adopted.

Unless consideration is given to the timing of adoption and application of different EMIR technical standards in this context, this would be a major concern for international financial, non-financial and mixed groups who wish to be able to continue both to invest in Europe and to prudently manage related business risks. Requiring the clearing and margining of such transactions executed within groups (and not with external counterparties) is not only unjustified in counterparty risk terms, but may actually be damaging in terms of creating new counterparty and operational risk (because so many group entities would be forced to deal with clearing houses, for example) and a disincentive to such investment and hedging decisions.

In light of the above, we propose that an OTC derivative transaction between an EU and non-EU group entity should be able to benefit from an intragroup exemption until the earlier of 3 years after the non-cleared margin rules apply or one year after an implementing act is adopted by the Commission under Art. 13(2) in respect of the relevant third country.

2. Interaction of Art. 1 FP and Article 7 GEN

We would like to seek clarification as to how the Art. 1 FP interacts with Art. 7 GEN. Article 1 FP refers to the calculation period of March, April May while Article 7 GEN refers to the "June, July and August".

3. Trade lifecycles

It is unclear which trade lifecycle events cause a trade to fall under scope of the margin rules. The article 7 GEN only mentions that IM does not have to be collected for "all new contracts from January of each calendar year" following the year of threshold calculation. It does not however elaborate on what "new contract" means and whether novated or compressed trades after the phase-in date are included, or whether the increases of notional amount for example are considered a new trade. It would be helpful to clarify the definition of "new trade".