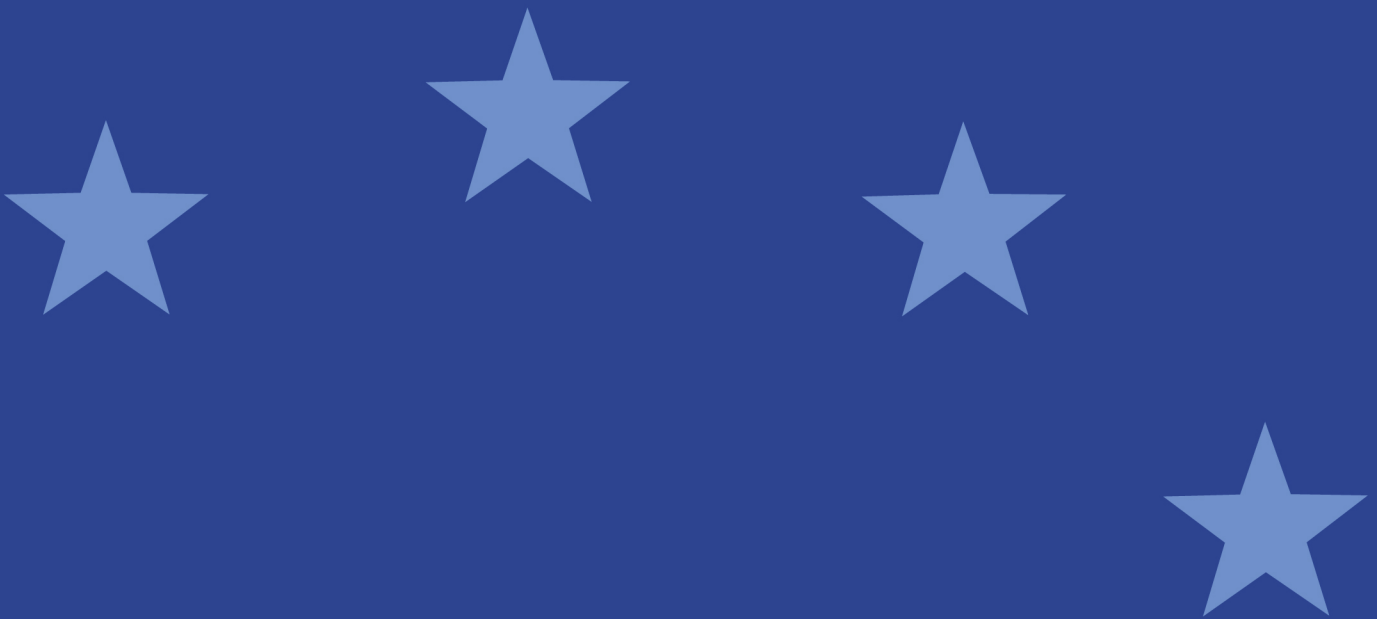




European Securities and
Markets Authority

Reply form for the Discussion Paper on the re- view of the clearing thresholds under EMIR



17 November 2021



Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the Discussion Paper on the review of the clearing thresholds published on the ESMA website.

Instructions

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

- use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
- do not remove the tags of type <ESMA_QUESTION_DP_EMIR_CT> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

- if they respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

Naming protocol

In order to facilitate the handling of stakeholders’ responses please save your document using the following format:

ESMA_DP_EMIR_CTs_NAMEOFCOMPANY_NAMEOFDOCUMENT.

e.g. if the respondent were ESMA, the name of the reply form would be:

ESMA_DP_EMIR_CTs_ESMA_REPLYFORM

Deadline

Responses must reach us by **19 January 2021**.

All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input - Consultations’.

Publication of responses



All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the headings 'Legal notice' and 'Data protection'.



General information about respondent

Name of the company / organisation	Association of the Luxembourg Fund Industry
Activity	Other Financial service providers
Are you representing an association?	<input checked="" type="checkbox"/>
Country/Region	Luxembourg

Introduction

Please make your introductory comments below, if any:

<ESMA_COMMENT_DP_EMIR_CTs>

The **Association of the Luxembourg Fund Industry (ALFI)** represents the face and voice of the Luxembourg asset management and investment fund community. The Association is committed to the development of the Luxembourg fund industry by striving to create new business opportunities, and through the exchange of information and knowledge.

Created in 1988, the Association today represents over 1.500 Luxembourg-domiciled investment funds, asset management companies and a wide range of businesses that serve the sector. These include depositary banks, fund administrators, transfer agents, distributors, law firms, consultants, tax advisory firms, auditors and accountants as well as specialist IT and communication companies. Luxembourg is the largest fund domicile in Europe and a worldwide leader in cross-border distribution of funds. Luxembourg-domiciled investment funds are distributed in more than 70 countries around the world.

We thank the ESMA for this new opportunity to provide feedback on the calibration of EMIR clearing obligation (CO) in commenting its discussion paper (DP). Indeed, after the entry into force of EMIR Refit (EU) 2019/834 in June 2019, market participants were able to provide feedback on the amended clearing regime.

We will respond to this consultation from the perspective of the Financial Counterparties (FCs), especially investment funds.

<ESMA_COMMENT_DP_EMIR_CTs>

Q1. Please explain if you see a need for further clarification on how to identify OTC contracts for the purpose of the calculation of the positions to be compared to the clearing thresholds.

<ESMA_QUESTION_DP_EMIR_CTs_1>

We do not see a need for further clarification.

<ESMA_QUESTION_DP_EMIR_CTs_1>

Q2. Please explain if you see a need for further clarification to identify OTC contracts that can be considered as reducing risks directly relating to commercial activity or treasury financing activity. And please mention any additional aspects to be further considered with regards to the hedging exemption.

<ESMA_QUESTION_DP_EMIR_CTs_2>

The use of OTC contracts to reduce risks relating to commercial activity or treasury financing activity is related to NFCs only, in accordance with Rec 20 of CDR (EU) 149/2013. Hence, under Art. 10 EMIR these hedging contracts are excluded from the calculation of the exposure.

According to the DP (§80 Figure 7), NFCs represent only 5% of the counterparties eligible to the CO, while UCITS funds represent a majority of 52%.

UCITS fund also proceed to hedging operations, in particular through the use of Foreign Exchange (FX) physically settled derivatives (FX Forwards, FX Swaps) in order to hedge their investment classes denominated in different currencies, in line with the ESMA opinion of 30 January 2017.

Art. 50 of the UCITS Directive provides strict investment restrictions in liquid financial instruments. Art. 1(2)a of the Directive emphasises the role of these investment restrictions as the shares of a UCITS fund can be subscribed by the public (i.e. including natural persons).

Thus, these hedging transactions play an important role to protect individuals against currency risk.

In light of the above provisions outlining the safety of the UCITS framework, we would like to recommend an exclusion of these FX hedging transactions from the calculation of the exposure against the clearing threshold, similarly to the regime benefiting to the NFCs.

Additionally, the clearing obligation currently does not apply to any foreign exchange derivatives, and where it was considered to implement a clearing obligation for foreign exchange derivatives, this was specifically for non-deliverable forwards, rather than the physically settled forwards widely used for hedging in the fund industry.

As such, the clearing threshold for foreign exchange derivatives causes, in its current state, funds' hedging activities to trigger them to become subject to the CO on IRDs and credit derivatives, despite these funds often having only marginal trading activity in these classes. Due to their low trading volume in these clearable instruments, funds may face difficulties to access clearing (in line with DP Paragraph 41) and face disproportionate operational burdens in implementing clearing arrangements for the low volume of trades.

This results in a deterrence effect for such funds to enter into IRD transactions¹, while being subject to the CO has no effect on the systemic risk of foreign exchange derivatives they trade.

¹ As rightly reflected in the Footnote 27 of the DP: 'It should be mentioned that in Luxembourg a lot of entities are funds which trade only in currency and ETDs. In addition, lots of funds choose not to calculate the exposure, which means that they have to be considered FC+. However, these funds will only subject to clearing if trading with IRDs and credit derivatives.'

Such considerations about are very much in line with Rec. 19 of EMIR (EU) 648/2012 that underlines the specific characteristics of FX derivatives as follows: *In determining which classes of OTC derivative contracts are to be subject to the clearing obligation, due account should be taken of the specific nature of the relevant classes of OTC derivative contracts. The predominant risk for transactions in some classes of OTC derivative contracts may relate to settlement risk, which is addressed through separate infrastructure arrangements, and may distinguish certain classes of OTC derivative contracts (such as foreign exchange) from other classes. CCP clearing specifically addresses counterparty credit risk, and may not be the optimal solution for dealing with settlement risk.*

Moreover, these considerations would represent a simple carve out with regards to the principle of inter-connectedness between the different asset classes stated in Rec. 7 of EMIR 2019/834.

<ESMA_QUESTION_DP_EMIR_CTs_2>

Q3. Please provide information and examples on how counterparties count fungible ETDs and OTC derivatives for the purpose of the calculation of the clearing thresholds?

<ESMA_QUESTION_DP_EMIR_CTs_3>

Under EMIR, ETDs are not to be included in the calculation of the exposure to be compared to the clearing thresholds.

<ESMA_QUESTION_DP_EMIR_CTs_3>

Q4. Please provide data and arguments to illustrate the potential impact of the lack of an equivalence decision under Article 2a of EMIR and what could be done to alleviate your concerns (besides an equivalence decision)? Please specify the kind of transactions and activities that would be affected and the purpose of those, and whether there are alternatives.

<ESMA_QUESTION_DP_EMIR_CTs_4>

Firstly, we took good note of the [Notice](#) issued by the European Commission on 18 February 2018 regarding the Brexit preparation in the field of post-trading, stating what follows:

- *As of the withdrawal date, derivatives traded on a UK regulated market will no longer fulfil the definition of exchange traded derivatives (ETDs) under EU law. According to Article 2(32) of MIFIR, ETDs are derivatives traded on an EU regulated market, or on a third-country market considered to be equivalent. Thus, under EU law, as of the withdrawal date, ETDs traded on a UK regulated market will be over-the-counter (OTC) derivative contracts.*
- *An ETD that becomes an OTC derivative will thus become subject to all EMIR requirements applicable to OTC derivatives transactions: all OTC derivatives transactions count towards the calculation of the clearing threshold in accordance with the provisions of EMIR, and will be subject to the EMIR clearing obligation where one has been adopted as well as certain risk mitigation techniques (notably the exchange of margins).*

Secondly, considering counterparties are still buying ETDs on UK markets, the shift to the OTC status impacts the calculation of their exposure and make them crossing the clearing thresholds, and thus become eligible to the CO while they were not before Brexit.

In particular, the products traded on the UK markets are listed options (calls and puts) and listed futures (e.g. on FTSE) with equity underlying. Our members observe that these products are only available, and



at reasonable price on UK markets. For an equivalent transaction in the EEA the buyer would have to go through and OTC transaction with a broker, which makes it more expensive.

Thirdly, when revisiting the clearing thresholds, EMIR Refit 2019/834 only took into account the usual level of business without including any impact of Brexit.

Fourthly, in line of the above, and in order to alleviate these counterparties to fall unexpectedly under the CO, we would like to recommend a temporary grandfathering to exclude the ETDs traded in the UK from the calculation of the exposure to be compared to the clearing threshold.

Moreover, considering these contracts are entered into through a market regulated under UK law, they are already subject to risk mitigation techniques, including clearing and margining.

This grandfathering would last until similar ETDs are proposed by markets located in the EEA. This period would have to be defined by the European Commission, in accordance with its agenda on the topic, including the Capital Markets Union. We suggest to apply this measure to the entire list of UK listed derivatives, that should be a simple and manageable solution.

<ESMA_QUESTION_DP_EMIR_CTs_4>

Q5. Please describe the scenarios when transactions do not qualify as hedging transactions.

<ESMA_QUESTION_DP_EMIR_CTs_5>

Typically, investment funds are net buyers of financial instruments in order to support their agreed investment policy, for instance for hedging purposes.

An isolated selling position would represent leverage and not qualify as hedging. Nevertheless, such position would need to be in line with the fund's investment policy.

<ESMA_QUESTION_DP_EMIR_CTs_5>

Q6. Please describe your views on how the EMIR framework works (also compared to other regimes) for the purpose of the clearing thresholds and the requirements triggered by those? Please provide examples and supporting data.

<ESMA_QUESTION_DP_EMIR_CTs_6>

Eligibility to the CO imposes to enter into clearing arrangements with a CCP. Currently UK based CCPs still provide a very competitive offer. The actual application of FRANDT principles are awaited. Meanwhile an extension of the current equivalence to access UK CCPs would be welcome, as it is ending on 30 June 2022.

<ESMA_QUESTION_DP_EMIR_CTs_6>

Q7. Considering the current coverage provided by the clearing thresholds in relation to credit derivatives and the different type of counterparties (FCs and NFCs); is there any aspect or issue you consider ESMA should look into or pay attention to? Please, in your answer, provide as granular details and any relevant data to illustrate your response.



<ESMA_QUESTION_DP_EMIR_CT_s_7>
No.

<ESMA_QUESTION_DP_EMIR_CT_s_7>

Q8. Considering the current coverage provided by the clearing thresholds in relation to interest rate derivatives and the different type of counterparties (FCs and NFCs); is there any aspect or issue you consider ESMA should look into or pay attention to? Please, in your answer, provide as granular details and any relevant data to illustrate your response.

<ESMA_QUESTION_DP_EMIR_CT_s_8>

In line with DP's Footnote 27, lots of funds choose not to calculate the exposure, which means that they have to be considered as FC+. However, these funds will only be subject to CO if trading with IRD or Credit derivatives.

In line with the response to Q2, the application of the principle of interconnectedness between the different asset classes makes that when a fund crosses the FX threshold, it will have to clear the few IRS it has in its portfolio even if it does not represent a material exposure.

This scheme has a deterrence effect on middle-sized funds to enter into IRD transactions.

Proportionality could be introduced with an entry floor (e.g. EUR 500 Mn of notional) on the IRD class, under which clearing would not be mandatory.

<ESMA_QUESTION_DP_EMIR_CT_s_8>

Q9. Considering the current coverage provided by the clearing thresholds in relation to commodity derivatives and the different type of counterparties (FCs and NFCs); is there any aspect or issue you consider ESMA should look into or pay attention to? Please, in your answer, provide as granular details and any relevant data to illustrate your response.

<ESMA_QUESTION_DP_EMIR_CT_s_9>
No

<ESMA_QUESTION_DP_EMIR_CT_s_9>

Q10. Considering the current coverage provided by the clearing thresholds in relation to equity derivatives and the different type of counterparties (FCs and NFCs); is there any aspect or issue you consider ESMA should look into or pay attention to? Please, in your answer, provide as granular details and any relevant data to illustrate your response.

<ESMA_QUESTION_DP_EMIR_CT_s_10>

As an alternative solution to our response to Q4 in case the proposed grandfathering cannot be implemented quickly enough, an increase of the equity threshold by EU 1 Bn would help solving the specific issue caused by the shift of the UK ETDs to OTC. We recall that the definition of the clearing thresholds was not taking into account the Brexit unsolved impacts.



<ESMA_QUESTION_DP_EMIR_CT_s_10>

Q11. Considering the current coverage provided by the clearing thresholds in relation to currency derivatives and the different type of counterparties (FCs and NFCs); is there any aspect or issue you consider ESMA should look into or pay attention to? Please, in your answer, provide as granular details and any relevant data to illustrate your response.

<ESMA_QUESTION_DP_EMIR_CT_s_11>

In line with the response to Q2, we support an exclusion of physically settled FX transactions from the calculation of the exposure, in particular for the entities that use these transactions for pure hedging purposes (e.g. UCITS), and considering the exemption of VM exchange on these products.

<ESMA_QUESTION_DP_EMIR_CT_s_11>

Q12. Beyond the different treatments between FCs and NFCs in the calculation, are there differences between the different types of counterparties that might justify a different calibration of the actual clearing thresholds? In addition, please consider if a different calibration of the current clearing thresholds by type of counterparty should apply in the same manner to all asset classes. Please provide any supporting data that might help illustrate your response.

<ESMA_QUESTION_DP_EMIR_CT_s_12>

In light of the above explanations regarding the UCITS funds activities, we think the thresholds would deserve to be calibrated under a specific manner for this type of counterparties that provide great service to the economy in a safely manner.

Indeed, UCITS funds investments are regulated by Art. 50 of the UCITS Directive that provides strict investment restrictions in liquid financial instruments. Art. 1(2)a of the Directive emphasises the role of these investment restrictions as the shares of a UCITS fund can be subscribed by the public (i.e. including natural persons), and can be redeemed any time.

UCITS fund also proceed to hedging operations via the buying of OTC derivatives to banking brokers. These transactions play an important role to protect individuals against currency risk, and interest rates risk.

<ESMA_QUESTION_DP_EMIR_CT_s_12>

Q13. Looking at the simulations presented in the paper and at the impact they would have, do you have any views on the sensitivities of the thresholds?

<ESMA_QUESTION_DP_EMIR_CT_s_13>

We noticed that an increase of EUR 1 Bn of each of the thresholds would keep the vast majority of the counterparties under the CO. Hence, we support such scenario for the equity asset class, in line with our response to Q10, and as an alternative solution to our response to Q4 recommending a grandfathering.

<ESMA_QUESTION_DP_EMIR_CT_s_13>

