# Position paper on EMIR

FINANS DANMARK

**Notat**

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## Executive Summary

The EU Commission has proposed a revised European Market Infrastructure Regulation. The proposal does not fundamentally alter the role of central counterparties (CCPs) in reducing contagion risk in the derivative markets, but rather aims to encourage further use of EU based clearing houses by allowing them greater freedom in their operations and products, enhance agility in the supervisory framework by easing requirements for authorisation and models, and to safeguard European financial stability and strategic autonomy. Thereby Commission intends to enable EU CCPs to grow business, with an aim of ensuring that clearing between EU entities takes place on EU CCPs under the auspices of EU authorities.

Finance Denmark very much **supports the continued development of the Capital Market Union**, including actively developing the frameworks for the market infrastructure of which CCPs are a key part. Likewise, Finance Denmark strongly **supports the proposed measures intended to secure the international competitiveness** of EU located clearing members but emphasises the key notion that the EU framework should be open and competitive rather than restricting or penalising the use of non-EU CCPs, and that it should avoid incurring transition risk.

To achieve this aim it is **crucial that the proposals are forward looking**, in so far that existing trades should be unaffected to avoid forcing moving contracts across CCPs which may be costly and will be risky. Likewise, it is crucial that the **Active account principle becomes voluntary, if pursued**. Besides the disadvantage for in particularly smaller firms, it risks forcing a disconnect in EUR clearing from clearing in other currencies, which banks from smaller currency-zones such as the Nordics are very much dependent on. This would lead to reduced possibility to reduce risk and cost through netting.

For the same reason, **we cannot support the contemplated CCP concentration tool**, as it in its very nature undermines the value proposition for banks and nonbank of using EU based central clearing by de facto applying higher prices on CCPs where efficient netting is accessible. For this reason, any concentration measure must be based on actual risk exposure to avoid penalising making the right choices from risk perspective. Likewise the concept of concentration should be delimited to substantial systemic important CCP activities only, rather than reflecting on all CCP activities.

In view of the above considerations and complexity of the proposal incl. level 2 and 3 mandates, Finance Denmark considers it **necessary to extend the (temporary) recognition of third-country Tier-2 CCPs** beyond June 2025.

## General comments

Finance Denmark fully supports development of the CMU to strengthen the EU and to secure the international competitiveness of EU located clearing members. The primary focus should be on creating an open financial EU framework, which does not restrict or penalise EU firms in competition with non-EU-firms. Ideally, this is achieved with a strong and competitive EU based clearing industry where not only EU firms, but also firms and market participants from other parts of the world, voluntarily find it attractive to conduct clearing at EU CCPs. In our view, more can be done to strengthen the EU clearing industry to reach this objective.

We strongly <u>recommend</u> that EMIR REFIT is forward-looking and focuses only on clearing of <u>new</u> transactions as it is both burdensome and risky to migrate existing transactions. If it is decided to include existing transactions, a potential issue would be that the migration of existing transactions would have to be effectuated via non-EU clearing members who can face both EU and non-EU CCPs (e.g., US banks), which would not be in line with the Commission's policy objectives.

However, we are **<u>not supportive</u>** of the Active Account principle as it will be disadvantageous for in particular smaller firms which are not members of Eurex and will fragment markets and disadvantage European firms in comparison with global competitors. If implemented, the proposal will damage the derivatives market and will make EU clearing members and participants less competitive than their counterparts outside of the EU. There is also a risk that the concentration to a few larger clearing members will increase. At best, we could support a principle of voluntary Active Accounts.

If pursued anyway, we agree with the EC that the Active Account principle and reporting requirements should apply only to products with high systemic importance to the EU. But it must be ensured that the EU framework do not harm EU firms and pose a competitive disadvantage for EU firms compared to non-EU firms by effectively requiring EU firms to have active accounts at EU and non-EU CCPs in order to have access to markets with sufficient liquidity. Any such additional costs for EU firms must be expected to be passed on to clients, incl. pension funds.

Depending on the implementation of the Active Account measures, such netting effects may be lost or reduced significantly. This may materialize in increased Initial margin and default fund contributions across EU and non-EU CCPs, and is not only a cost issue, but also a risk issue to the clearing members through the risk mutualisation mechanism, which is essential to central clearing. Any measure should balance cost and risk to the clearing members against the desired reduction in systemic risk.

We are **not supportive** of the CCP concentration risk tool (as amended in CRD article 104) as we cannot see how to design this tool without harming EU firms' competitiveness. Using pillar 2 tools, which could entail additional own funds requirements, is in our view not an appropriate tool to address concentration risks. If the tool is kept in the regulation, we strongly recommend that actual risk exposures (Trade Exposure, Deltas) rather than notional registered or notional outstanding is used as concentration measures. Additionally, concentration risk should be specified further and be limited to services of substantial systemic importance and not towards CCPs in general.



To fully assess the EMIR REFIT proposal and its impact requires an overview of the full legislative package, including level 2 and 3 texts. Considering the time needed for political negotiations and preparation of the level 2 texts, we see a need for an extension of the (temporary) recognition of third-country Tier-2 CCPs beyond June 2025 to facilitate orderly preparation and sufficient time for participants to analyse their portfolios and decide on needed relocations. In our view, the migration of new transactions needs to take place over a much longer time horizon, which would also be in line with the Commission's proposal as it allows EU firms to continue clearing part of their transactions outside EU and with the above recommended gradual build-up of EU clearing activity,

If relevant, we also see a need for significant lead times for migration of transactions, which must always be respected for all decisions related to

- o products of substantial systemic importance
- o calibrations of levels in active accounts, and
- o third-country recognitions

## Specific comments

**Intra-group transactions (art. 3):**

We welcome the simplified rules for intra-group transactions with entities in third countries.

**Active account (art. 7a):**
As noted previously, we are **not supportive** of the Active Account principle. Beyond this, the effects of Art 7(a) are unclear and much depends on the details in the regulatory technical standards that ESMA will develop, e.g. the proportion of activity in each category of the derivative contracts that must be cleared at an authorized EU-CCP. The proportion of activity will be very difficult to define and it is difficult to see how this will work in practice. A solution with quantitative targets is undesirable. Should the EU nevertheless choose to implement quantitative requirements, the active ac-count requirement at EU CCPs should only apply to new transactions. It is also important that the "proportion of activity" is established on Level 1. If calibrating the level of activity (be it in Level 1 or 2), and subsequently estimating related concentration risk, it would be preferable to look at more risk-sensitive measures such as Initial Margin or delta/DV01 on new trades rather than new notional registered or outstanding amounts, measures that do not portray a correct picture of risk, and, hence, systematic risk.

For smaller market participants (FCs and NFCs), the requirement to hold an active account at an EU CCP will be very costly. Market making activities and client clearing services therefore needs to be carved out. Regarding client clearing services the proposed requirements could potentially create conflicts of interest between the clearing members and their clients; if the clients request their trades to be cleared at a Tier 2 CCP this may exhaust the clearing members capacity, limiting the possibility to clear its own trades on Tier 2 CCPs and perhaps forcing the clearing member to clear additional trades at EU CCPs to meet the quantitative targets. Unless client clearing services are carved out from the proposed requirements, this might lead to clearing members having to restrict the client clearing possibilities.

Art 7(a) also needs to be amended so that only OTC derivatives that are subject to the clearing obligation are covered.

The proposal may also have the unintended consequence of forcing market participants to cease trading and clearing derivatives transactions as the costs may be too high. Since the proposal will put EU market participants at a significant competitive disadvantage, a comprehensive cost benefit analysis and analysis of financial stability risks need to be made before it is implemented. From our perspective, the EU Com-mission is overstating the risks of clearing at Tier-2 CCPs.

The reporting requirement under Art 7(a)(4) is very cumbersome and costly for smaller market participants. It should be sufficient with the reporting that marketing partici-pants and CCPs do to Trade Repositories and supervisory authorities in accordance with EMIR.

The current proposal and suggested powers to ESMA are unclear and should be clarified to ensure:

- that the rule is transformed to an optional rather than mandatory requirement by way of being constructed as an obligation to have opened an account at an EU CCP but not to impose quantitative requirements on the use of the account
- ESMA must demonstrate clear systemic financial stability risks
- active account requirement should only be applicable for new transactions
- a sufficiently long implementation phase must be ensured
- market makers and client clearing should be excluded
- minimum proportion to be set using a risk-based approach (IM or default fund contribution) rather than looking at notional or number of transactions.

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Finally, we would like to emphasize that IM and default contribution requirements for EU firms and reduction of netting effects are not compatible with systemic risk reduction, which is the purpose of the active account requirement.

**Transparency on margin models for clients (art. 38):**

We support transparency of margin models towards clients, but this information should come directly from the CCP's by enhancing the existing art. 38(7). Concretely, we would be concerned that clearing members would not have the information on margin models they are expected to provide.

**Other proposed changes**

We suggest making necessary amendments to EMIR level 1 and 2 in order to make the exemption from margin requirements for single stock equity options and index permanent.

We support the ESMA conclusion in their report from 10 November 2020 (ESMA70-156-3351) to exempt certain non-price forming post trade risk reduction services from the clearing obligation and suggest that necessary amendments to EMIR level 1 and 2 are made.