MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

July 18, 2017

Via Electronic Submission

European Commission
Avenue du Bourget, no 1
1140 Evere
Belgium

Re: European Commission Proposal to Amend the European Market Infrastructure Regulation ("EMIR")

Dear Sir or Madam:

Managed Funds Association ("**MFA**")[1] welcomes the opportunity to provide comments to the European Commission ("**Commission**") on its Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No. 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories, dated 4 May 2017 ("**EMIR Amending Regulation**").[2]

Throughout the EMIR[3] Level I legislative process, MFA engaged with policymakers in the European Union ("**EU**") to provide constructive input on a number of important issues related to regulation of the EU over-the-counter ("**OTC**") derivatives market. [4] MFA strongly supports the objective to promote central clearing and thereby: (i) increase transparency of the derivatives market; (ii) reduce counterparty and operational risk in trading; and (iii) enhance market integrity and oversight. In addition, MFA strongly supports the goals and efforts of the Commission and other EU authorities to reduce systemic risk in the derivatives market,

[1] MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals, and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

[2] Available at: https://ec.europa.eu/info/law/better-regulation/initiatives/com-2017-208_en.

[3] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories Text with EEA relevance, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R0648&from=EN.

[4] *See e.g.*, MFA letter to the Commission on its Public Consultation on Regulation (EU) No. 648/2012 on OTC Derivatives, Central Counterparties and Trade Repositories, dated August 13, 2015, available at: https://www.managedfunds.org/wp-content/uploads/2015/08/European-Commission-EMIR-Review-Final-MFA-Consolidated-Response-and-Cover-Letter.pdf.

including by supporting measures that enhance transparency and proportionate risk mitigation techniques in the derivatives market as well as consistency of regulation globally.

MFA appreciates the Commission's efforts "to simplify the rules and make them more proportionate,"[5] and we support the EMIR review process. We also applaud the Commission for proposing a number of amendments that we believe will improve the efficacy of EMIR, and the functioning of the EU derivatives market.

Therefore, in our detailed response to the EMIR Amending Regulation, set out in the Appendix to this letter, MFA makes recommendations to address the practical issues that have arisen with the application of the EMIR framework.[6] In addition, we summarize our key recommendations below.[7]

(1) **Financial Counterparty Definition** – MFA strongly recommends that the Commission work with the European Parliament and the Council (collectively, the "**EU Authorities**")[8] to revise the proposed definition of "financial counterparty". As drafted in the EMIR Amending Regulation, the proposed definition would apply to all alternative investment funds ("**AIFs**") worldwide. Accordingly, MFA urges the EU Authorities to amend the proposed definition to capture only AIFs that are established in the EU or managed by an alternative investment fund manager ("**AIFM**") authorized or registered in accordance with Directive 2011/61/EU ("**AIFMD**").

(2) **Single-Sided Reporting** – MFA urges the EU Authorities to amend the reporting hierarchy in the proposed single-sided reporting regime, so that in a trade between a dealer and an AIF that are both FCs, only the dealer FC is required to report the transaction.

(3) **Equivalence under EMIR Article 13** – MFA urges the Commission to clarify that, for purposes of relying on equivalence acts under Article 13 of EMIR, an entity is deemed "established" in a third country if it is either legally incorporated in and/or subject to regulation in that third country.

(4) **Frontloading and Backloading Obligations** – MFA supports retention of the Commission's proposed amendments to: (i) Article 4(1)(b) of EMIR, which eliminates the obligation to clear OTC derivatives contracts entered into prior to the clearing obligation taking effect (*i.e.*, the "frontloading"[9] obligation); and (ii) Article 9(1)(a),

[5] EMIR Amending Regulation at 2, Explanatory Memorandum, paragraph 1.1, Reasons for and objectives of the proposal.

[6] *See id*., discussing the practical issues that have resulted over the more than four years since EMIR entered into force.

[7] In formulating MFA's position, we have worked closely with other global buy-side associations, including the Alternative Investment Management Association, in order to come to a view that is fully reflective of the interests of the global asset management industry.

[8] MFA notes that, our understanding is that, the European Parliament and the Council will now propose amendments to the proposed EMIR Amending Regulation. As a result, in this response, we will address drafting comments collectively to the Commission, the European Parliament, and the Council.

[9] MFA notes that, the "frontloading" obligation applies to derivatives contracts entered into or novated on, or after, the date from which the clearing obligation takes effect.

which removes the requirement to report transactions terminated prior to 12 February 2014 (*i.e.*, "backloading"[10] obligation).

(5) **FRAND Principle** – MFA applauds the Commission's decision to require clearing members and clients[11] that provide clearing services to do so under "fair, reasonable and non-discriminatory commercial terms" (the so-called "FRAND" principle). In furtherance of this principle, MFA would request that the Commission adopt a delegated act in accordance with Article 82 of EMIR[12] to specify the conditions under which commercial terms will be considered fair, reasonable, and non-discriminatory.

(6) **Leverage Ratio** – MFA applauds the Commission for engaging with other EU authorities to address the impediments to client clearing created by the leverage ratio under the Capital Requirements Regulation ("**CRR**"),[13] and to ensure that the cost of clearing derivatives remains affordable.

(7) **Access to TR Data –** MFA urges the EU Authorities to enhance the required policies and procedures for protection of confidential, sensitive, and proprietary information requested by EU and third country authorities or reported to trade repositories ("**TRs**"). In addition, we urge the EU Authorities to ensure that, where counterparties execute a transaction on an anonymous basis on a regulated market, multilateral trading facility ("**MTF**"), or organized trading facility ("**OTF**") and then clear that transaction, Article 81(3a) would not permit one party to access data from a TR related to the identity or legal entity identifier ("**LEI**") of its original counterparty or its original counterparty's clearing member.

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[10] MFA notes that, the "backloading" obligation applies to "Terminated Transactions", which are defined to mean transactions that were: (i) entered into before 16 August 2012 and were still outstanding on that date; or (ii) entered into on or after 16 August 2012, and which terminated prior to 12 February 2014.

[11] Under the EMIR text, a "client" is defined to mean "an undertaking with a contractual relationship with a clearing member of a CCP which enables that undertaking to clear its transactions with that CCP".

[12] Article 82 of EMIR empowers the Commission to adopt delegated acts.

[13] *See* Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012, available at: https://ec.europa.eu/transparency/regdoc/rep/1/2016/EN/COM-2016-850-F1-EN-MAIN.PDF.

MFA thanks the Commission for the opportunity to provide comments on the EMIR Amending Regulation. We would welcome the opportunity to discuss our views in greater detail. Please do not hesitate to contact Michael Pedroni, Carlotta King or the undersigned at (202) 730-2600 with any questions the Commission or its staff might have regarding this letter or the EMIR Amending Regulation.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

APPENDIX

Terms defined in the cover letter have the same meaning when used in this Appendix. Furthermore, unless the context otherwise requires, references to Articles of EMIR are references to EMIR as it would be amended by the EMIR Amending Regulation.

Article 2(8): Definition of "Financial Counterparty"

MFA respectfully recommends that the EU Authorities revise the proposed definition of "financial counterparty" to capture only AIFs that are established in the EU or managed by an AIFM authorized or registered in accordance with AIFMD[14]

In the EMIR Amending Regulation, the Commission has proposed to amend the definition of "financial counterparty" to include "an AIF as defined in Article 4(1)(a) of [AIFMD]". This definition is broader than the "financial counterparty" definition in the current EMIR text, which applies only to "an alternative investment fund *managed by AIFMs authorised or registered in accordance with Directive 2011/61/EU*" (emphasis added).[15] In its Explanatory Memorandum to the EMIR Amending Regulation, the Commission's stated objective for this change is that:

> "Article 1(1) brings into the definition of a financial counterparty contained in EMIR Article 2 alternative investment funds registered under national law that are currently considered non-financial counterparties under EMIR ... These entities will be treated as financial counterparties under EMIR".[16]

MFA's, interpretation of this language is that the Commission's intention with the proposed new definition is to require any AIFs currently treated as non-financial counterparties ("**NFCs**") (*i.e.*, because they are established in the EU or managed by and authorized or registered AIFM) to be treated as financial counterparties **("FCs")** going forward for the purposes of EMIR.

Assuming our interpretation is correct, MFA is concerned that the proposed text of Article 2(8) of EMIR does not achieve the Commission's stated objective. As drafted, Article 1(1) of the EMIR Amending Regulation would include all AIFs as defined under AIFMD in the definition of "financial counterparty."[17] Thus, the definition would inadvertently capture all AIFs anywhere in the world and subject them to direct regulation under EMIR, regardless of where any such AIF is legally established or whether or not its AIFM is authorized or registered in accordance with AIFMD.

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[14] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:174:0001:0073:EN:PDF.

[15] EMIR, Article 2(8).

[16] EMIR Amending Regulation at 14, Explanatory Memorandum, paragraph 5.2, Detailed explanation of the specific provisions of the proposal, Amendments to the clearing obligation (EMIR Articles 2, 4, new 4a, new 6b, 10, 85 and 89), *Financial counterparties*.

[17] *See supra* note 15.

EMIR is very clear in which circumstances it has extraterritorial effect,[18] and MFA hopes that the Commission is not intending to alter this settled position. MFA is not aware of any suggestion by the Commission that it was its intention to alter such position either during the Commission's extensive assessment of the EMIR rules currently in place from May to August 2015 or in the EMIR report adopted by the Commission in November 2016.[19]

In addition, MFA does not believe that national competent authorities have the necessary resources to take on the supervision of so many additional market participants. The proposed definition would cover a very substantial number of true third country entities ("**TCEs**"), such as an AIF established in the U.S. with a U.S. manager that is not an AIFM authorized or registered in accordance with AIFMD. In the case of such an AIF, it would be subject to robust and equivalent regulation in the U.S., such that requiring national competent authorities to supervise the activities of such as an AIF would seem to be an inefficient and unnecessary use of the national competent authorities' resources.

MFA, therefore, considers it of vital importance that the EU Authorities amend the drafting of proposed Article 2(8) of EMIR to clarify this issue and fulfill the Commission's intention and stated objective. Specifically, we request that the EU Authorities extend the definition of "financial counterparty", not to all AIFs, but rather to AIFs established in the EU, and continue to capture, AIFs managed by authorized or registered AIFMs, as is the case under the existing definition of "financial counterparty". Thus, MFA suggests that the EU Authorities amend the proposed definition of "financial counterparty", insofar as it applies to AIFs, by adding the following underlined wording:

> "an AIF as defined in Article 4(1)(a) of Directive 2011/61/EU <u>that is established in the Union and/or managed by an AIFM[20] authorised or registered in accordance with Directive 2011/61/EU</u>".

In suggesting this change, MFA notes that an AIF would be an FC under this definition if it were:

(1) Established in the EU and managed by an AIFM authorized or registered in accordance with AIFMD;

(2) Established outside of the EU but managed by an AIFM authorized or registered under AIFMD; or

[18] *See* Article 4(1)(a)(v) and Article 11(12) of EMIR and Commission Delegated Regulation (EU) No 285/2014 of 13 February 2014 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on direct, substantial and foreseeable effects of contracts within the EU and to prevent the evasion of rules and obligations.

[19] *See* Report from the Commission to the European Parliament and the Council under Article 85(1) of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, dated 23 November 2016, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX%3A52016DC0857.

[20] Technically, the reference to "AIFMs" in the existing definition should be amended to "an AIFM" given that an AIF will generally have only one AIFM.

(3) Established in the EU but not managed by an AIFM authorized or registered under AIFMD.

We believe that it is an AIF described in (c) that the Commission is seeking to encompass within the proposed revised definition of "financial counterparty". As a result, we believe that the language suggested above would achieve the Commission's stated objective. In contrast, we believe that adopting the wording currently set out in the EMIR Amending Regulation, and thereby subjecting all AIFs worldwide to direct regulation under EMIR, is not consistent with the stated objectives of the Commission or the goal of simplifying the rules and making them more proportionate.[21]

Article 4(1)(b): Elimination of Frontloading Obligation

MFA strongly supports the Commission's decision to eliminate the clearing obligation for derivatives contracts entered into or novated on, or after, the date from which the clearing obligation takes effect (*i.e.*, the "frontloading" obligation). Therefore, we support retention of the proposed amendment to Article 4(1)(b) in the final EMIR text.

MFA has consistently advocated for the elimination of frontloading due to its impact on the pricing of derivatives contracts that are not cleared at the time at which the parties enter into and then become subject to the clearing obligation. Accordingly, MFA applauds the Commission's decision to modify EMIR to remove the frontloading requirement in its entirety for classes of derivatives that become subject to mandatory clearing. We believe that such an approach would prevent the market disruptions that would result from the frontloading obligation, and would not result in any increase in systemic risk.[22]

Article 4(3)(a): FRAND Principle for Access to Clearing Services

A. Client Clearing Services

MFA applauds the Commission's decision to require clearing members and clients that provide clearing services to do so under "fair, reasonable and non-discriminatory commercial terms" (the so-called "FRAND" principle). In furtherance of this principle, MFA believes it is essential that the Commission adopt a delegated act in accordance with Article 82 of EMIR[23] to specify the conditions under which commercial terms will be considered fair, reasonable, and non-discriminatory. In particular, we would encourage the Commission's delegated act, among other things, to require clearing members to have conflicts of interest policies that create communication barriers (*i.e.*, firewalls) between the clearing and trading desks.[24]

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[21] *See supra* note 5.

[22] MFA notes that such derivatives, in any event, would be subject to the Commission's final regulatory technical standards imposing margin requirements on non-centrally cleared derivatives contracts (the "**EMIR Margin Rules**"). *See* Commission Delegated Regulation (EU) 2016/2251 of 4 October 2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R2251&rid=1.

[23] *See supra* note 12.

[24] *See e.g.*, U.S. Commodity Futures Trading Commission ("**CFTC**") final rule on "Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker

MFA strongly supports the goals and efforts of EU policymakers to reduce systemic risk in the derivatives market, a core aspect of which is transitioning the OTC derivatives market to greater central clearing. As a result, MFA has supported the proposed scope of the EMIR clearing obligation with respect to certain interest rate and credit derivatives suggested in the European Securities and Market Authority's ("**ESMA**") consultation papers.[25]

MFA notes that clients are a vital part of the derivatives markets and their full participation is important to the success of central clearing in the EU. However, at present, clients exclusively access clearing and central counterparties ("**CCPs**") indirectly through clearing members, rather than becoming direct members of CCPs, for a variety of reasons, both financial and operational. Thus, clients necessarily rely on the availability of client clearing services offered by clearing members to comply with EMIR's clearing obligation. For that reason, it is critical that client clearing services remain available pursuant to fair, reasonable, and non-discriminatory commercial terms and pricing to enable clients to have fair and equal access to CCPs and to comply with the EMIR clearing obligation. Without access to clearing services on such terms, market participants may be forced to cease transacting derivatives or engage in greater non-cleared OTC derivatives trading, which would lead to increased risk in the financial markets.

Accordingly, MFA applauds the Commission's decision to introduce the "FRAND" principle in proposed amended Article 4(3)(a). We believe that the inclusion of this principle is a strong demonstration by the Commission that it values clearing and clients' participation in the cleared derivatives market.

However, MFA notes that Article 39(7) of EMIR already requires CCPs and clearing members to provide certain client services on reasonable commercial terms.[26] These broad requirements have not proven sufficient to ensure that clients are being offered clearing solutions on a FRAND basis. Therefore, as a further step forward on bolstering client access to clearing, MFA would appreciate it if the Commission would adopt a delegated act in accordance with Article 82 of EMIR to specify the conditions under which commercial terms will be considered fair, reasonable, and non-discriminatory. Through the process of adopting such a delegated act, the Commission will be able to engage in a robust technical discussion with market participants of the specific issues that the Commission needs to address in relation to client clearing solutions to further promote client clearing.

Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants", 77 Fed. Reg. 20128 (Apr. 3, 2012), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2012-5317a.pdf.

[25] *See* MFA Response Consultation Paper on the Clearing Obligation under EMIR (no.1), dated August 8, 2014, available at: https://www.managedfunds.org/wp-content/uploads/2014/08/ESMA-Consultation-on-EMIR-Clearing-Obligation-of-IRS-Final-MFA-Response.pdf; MFA Response Consultation Paper on the Clearing Obligation under EMIR (no.2), dated September 17, 2014, available at: https://www.managedfunds.org/wp-content/uploads/2014/09/ESMA-Consultation-on-EMIR-Clearing-Obligation-of-CDS-Final-MFA-Response.pdf; and MFA Response on the Consultation Paper on the Clearing Obligation under EMIR (no.4), dated July 15, 2015, available at: https://www.managedfunds.org/wp-content/uploads/2015/07/ESMA-Consultation-Paper-on-Clearing-Additional-IRS-Classes-MFA-Final-Response-7-15-20151.pdf.

[26] Article 39(7) of EMIR specifically provides that "CCPs and clearing members shall publicly disclose the levels of protection and the costs associated with the different levels of segregation that they provide and shall offer those services on reasonable commercial terms."

In particular, we believe that it would further implementation of the FRAND principle if the Commission's delegated act required clearing members to have conflicts of interest policies that create firewalls between the clearing and trading desks. We feel that without such required firewalls it could lead to conflicts that would adversely affect clients by causing clearing members to link their clearing decisions to trade execution decisions. In the U.S., we have seen the implementation of such mandatory regulatory firewalls[27] reduce such conflicts and lead to fairer and more equitable pricing and trade terms.

MFA stresses that it is necessary for the Commission to move quickly to adopt such a delegated act to ensure that there is true adoption and implementation of the FRAND principle by market participants. We believe that adoption of the FRAND principle, in turn, will facilitate a reduction of systemic risk by encouraging more clearing of sufficiently liquid and standardized products.

B. Leverage Ratio under the Capital Requirements Regulation

MFA applauds the Commission for engaging with other EU authorities to address the impediments to client clearing created by the leverage ratio under the CRR, and to ensure that the cost of clearing derivatives remains affordable.

MFA has strong concerns about the treatment of segregated initial margin for centrally cleared derivatives exposure under the leverage ratio. The leverage ratio contained currently in the CRR is problematic because it does not provide a capital offset for client initial margin ("**IM**") posted on centrally cleared derivatives transactions. As a result, we believe that, if the Commission does not address this issue, the lack of an offset will threaten the ability of clients to use centrally cleared derivatives and could limit the ability of certain clients to hedge their risks.

Given that cleared derivatives are traded in global markets, MFA has previously requested that the Commission engage with regulators in other jurisdictions to ensure that the leverage ratio under the CRR would not raise the cost of clearing on a global basis such that clearing members are disincentivized from providing client clearing services. In particular, MFA previously encouraged the Commission to engage with regulators in the U.S., where there are increasing calls for a recalibration of the leverage ratio rules by providing an offset for clearing members to the extent that client IM is posted to the CCP, or is segregated under the U.S. regulatory regime.[28]

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[27] *See supra* note 24.

[28] *See* U.S. Department of the Treasury Report to President Donald J. Trump under Executive Order 13772 on Core Principles for Regulating the United States Financial System, "A Financial System That Creates Economic Opportunities, Banks and Credit Unions", June 2017, at p. 126 (recommending "significant adjustments" to the supplementary leverage ratio and a deduction from the leverage exposure denominator for IM for centrally cleared derivatives), available at: https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf. Federal Reserve Board Governor Powell has also called for a recalibration of the leverage ratio in the U.S. at MFA's Global Finance Forum in Washington, D.C. on April 20, 2017, noting its damaging impact on client clearing. CFTC Acting Chairman Giancarlo has echoed similar concerns in support of a recalibration. *See* "Changing Swaps Trading Liquidity, Market Fragmentation and Regulatory Comity in Post-Reform Global Swaps Markets," Remarks of Acting Chairman J. Christopher Giancarlo before the International Swaps and Derivatives Association 32nd Annual Meeting in Lisbon, Portugal,

MFA applauds the Commission for its efforts to permit clearing members subject to CRR to reduce the leverage ratio exposure measure by the IM received from clients for derivatives cleared through qualifying CCPs.[29] However, for the EMIR clearing obligation to function as the Commission intends, it is extremely important that the EU Authorities amend the CRR to address the issues faced by clearing members in providing client clearing services. Such an amendment would ensure that clients that are subject to the EMIR clearing obligation have robust and viable access to CCPs.

In MFA's view, amendment of the CRR and the introduction of a FRAND principle are both required in order to alleviate the difficulties faced by many clients in accessing clearing services. Therefore, we would urge:

(1) The Commission to retain the FRAND principle, but bolster its efficacy by adopting a delegated act to specify the conditions under which commercial terms will be considered fair, reasonable, and non-discriminatory; and

(2) The EU Authorities to amend the leverage ratio in the CRR to provide an offset for posted client IM.

Article 4(a): FCs Subject to EMIR's Clearing Obligation

A. Removal of Certain Small FCs from the Scope of the Clearing Obligation

MFA has consistently advocated for all market participants subject to EMIR also to be subject to the clearing obligation for OTC derivative contracts. To this end, MFA expresses some concern with, and requests that the EU Authorities give careful consideration to the proposal to exclude certain small FCs from the EMIR clearing obligation.

Currently, under the regulatory technical standards ("**EMIR Clearing RTS**") related to the EMIR clearing obligation, all FCs are subject to the clearing obligation.[30] The only distinction the EMIR Clearing RTS make between FCs is that it provides different phase-in periods with respect to the clearing obligation for different FCs based on their outstanding gross notional amount of derivatives activity over a specific period of time.[31] However, in the EMIR Amending Regulation, the Commission is proposing in Article 4(a) not to apply the EMIR clearing obligation to FCs whose aggregate derivatives activity of its worldwide group on the last day of March, April and May of each year are below any of the five clearing thresholds specified pursuant to Article 10(4)(b) of EMIR. As a result, a number of smaller FCs would never be required to clear any OTC derivatives transactions.

MFA understands that the Commission is proposing to exclude certain smaller FCs from the clearing obligation because some of these FCs face impediments to their access to clearing and putting in place the arrangements with clearing members that are necessary for clearing of the

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May 10, 2017 (expressing concerns with the "misguided application" of the supplementary leverage ratio (SLR) to swaps clearing and proposing suggested SLR rule changes to reduce capital costs for clearing members).

[29] *See supra* note 13.

[30] *See e.g.*, Commission Delegated Regulation (EU) 2015/2205 of 6 August 2015 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation, dated 6 August 2015, at L 314/17, Article 2, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R2205&from=EN.

[31] *See id*.

FCs contracts. MFA also appreciates that there are capacity issues in the cleared derivatives markets. Therefore, we understand that the Commission has a difficult task in balancing the burdens on smaller FCs with the benefits to the market of central clearing. However, we believe the Commission's primary focus should be on improving client access to clearing and the economics of client clearing, rather than on exempting certain classes of clients from the clearing obligation.

As a result, MFA has concerns with excluding any FCs (even small FCs) from the EMIR clearing obligation because it reduces the international convergence between the scope of the EU's clearing obligation and the clearing obligation in other jurisdictions (such as the U.S.). Currently, there is international convergence between the EMIR Clearing RTS and the corresponding clearing rules in the U.S. because both jurisdictions subject investment firms, clearing members, and other financial entities to their clearing obligations.[32] While we acknowledge that, under CFTC rules, there is an exemption from the U.S. clearing obligation for credit institutions with $10 billion or less in assets, there is no U.S. exemption for smaller U.S. asset managers or investment funds.[33]

MFA is also concerned that disapplying the clearing obligation to certain smaller FCs and reducing international convergence of the scope of the clearing obligations might fragment or impair the derivatives market. For example, we worry that the lack of such international convergence could affect liquidity by causing it to shift due to some market participants seeking to take advantage of competitive imbalances between different jurisdictions and larger and smaller market participants. Thus, we are concerned that any seeming change in EU regulatory goals, or any other perceived disharmony between jurisdictions, may influence market behavior in a manner that could further exacerbate market volatility and risk.

Therefore, MFA notes our concerns with the proposed clearing exclusion for smaller FCs, and we encourage the EU Authorities to give careful consideration to this exclusion given the potential implications for international convergence and the risk reduction benefits of centrally clearing.

B. Determination of Gross Notional Value

MFA urges the EU Authorities to provide guidance that the calculation of the gross notional value of an equity option transaction may take account of a delta adjustment.[34]

MFA notes that, for an FC to determine whether it has exceeded any of the clearing thresholds specified pursuant to Article 10(4)(b) of EMIR, the FC must determine the "gross notional value" of each of its OTC derivative contracts. This determination is not straightforward in the context of certain OTC derivative contracts, such as options. ESMA's guidance in its Questions and Answers document states that the notional amount is the "reference amount from

[32] *See id. See also e.g.*, CFTC final rule on "Clearing Requirement Determination Under Section 2(h) of the CEA", 77 Fed. Reg. 74284 (Dec. 13, 2012), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2012-29211a.pdf.

[33] *See* CFTC final rule "End User Exception to the Clearing Requirement for Swaps", 77 Fed. Reg. 42560 (July 19, 2012), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2012-17291a.pdf.

[34] MFA notes that a "delta adjustment" refers to adjusting the gross notional amount of an option to reflect how valuable a replicated portfolio would be if it only contained the underlying equity position referenced in the option.

which contractual payments are determined in derivatives markets" or "the value of a derivative's underlying assets at the applicable price at the transaction's start (in the case of options, this is not the premium)". [35] This guidance does not appear to allow for a delta adjustment of the notional amount of an equity option transaction.

Accordingly, MFA urges the EU Authorities to provide guidance that the calculation of the gross notional value of an equity option transaction may take account of a delta adjustment. The delta adjusted notional value of an equity option is a more accurate measure of the value of an option. As a result, it is a widely accepted practice in the options market to use such delta adjusted notional values. For this reason, similar regulations in the EU permit market participants to value options using a delta adjusted notional amount. For example, EU Authorities have already recognized this necessary practice of delta adjusting options in the regulatory technical standards on calculations for positions in relation to short selling.[36] Therefore, providing the requested guidance as it relates to EMIR would lead to convergence across EU regulations.

Without guidance that such a delta adjustment is permissible, market participants will continue to use the unadjusted gross notional value of equity options to calculate whether they exceed the clearing threshold. As a result, the value of market participants may be artificially higher than appropriate for purposes of the clearing threshold test for both FCs and NFCs and may result in more participants than the Commission intends being subject to the clearing obligation. MFA submits that such clarification should apply to all threshold determinations under EMIR and not solely the clearing threshold calculation.

C. Contracts Subject to Clearing Obligation

MFA requests that the EU Authorities clarify that only contracts declared subject to EMIR's clearing obligation and entered into after the FC becomes subject to the clearing obligation are required to be cleared.

At present, Article 4a(1)(b) of EMIR indicates that FCs are subject to the clearing obligation for "future OTC derivative contracts", and requires FCs to clear such contracts within four months of becoming subject to the clearing obligation. However, the EMIR Amending Regulation does not specify what constitutes "future OTC derivative contracts".

Because there is a four-month period between when an FC determines that it has exceeded the clearing threshold and when the FC becomes subject to the clearing obligation, MFA believes that the Commission's intention is to require FCs to clear only the contracts that it enters into after it becomes subject to the clearing obligation (*i.e.*, contracts the FC enters into after the four-month period). However, because the language in, the EMIR Amending Regulation is unclear, it might be read as introducing another form of frontloading window. Specifically,

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[35] Questions and Answers Implementation of the Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR), at 9, dated 3 April 2017, available at: https://www.esma.europa.eu/sites/default/files/library/esma70-1861941480-52_qa_on_emir_implementation.pdf.

[36] *See* Article 11 of Commission Delegated Regulation (EU) No 918/2012 of 5 July 2012 supplementing Regulation (EU) No 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps with regard to definitions, the calculation of net short positions, covered sovereign credit default swaps, notification thresholds, liquidity thresholds for suspending restrictions, significant falls in the value of financial instruments and adverse events, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R0918&from=EN.

Article 4a(1)(b) could be read to subject transactions to EMIR's clearing obligation that an FC enters into after it calculates that it has exceeded the clearing threshold (*i.e.*, after the last day of May) but before the expiry of the four-month period before which the FC is subject to the clearing obligation.

Given the Commission's elimination of the frontloading obligation in Article 4(1)(b), MFA does not believe that the Commission's intention is to create a new frontloading obligation in this context. As a result, MFA requests clarification that "future OTC derivative contracts" refers to contracts entered after the clearing obligation applies to an FC.

D. Evidence Demonstrating an FC No Longer Exceeds the Clearing Threshold

MFA encourages the EU Authorities to amend Article 9 to provide that, once an FC notifies ESMA and a national competent authority that it no longer exceeds the clearing threshold, its notification is sufficient evidence such that the clearing obligation will no longer apply to the FC from the time of such notification.

Under current Article 4a(2) of EMIR, an FC would cease to be subject to EMIR's clearing obligation once it demonstrates to its national competent authority that it no longer exceeds the clearing threshold. MFA is concerned by the lack of specificity around what proof might be necessary to satisfy a national competent authority for these purposes.

As a result, MFA suggests that the EU Authorities amend EMIR to provide that the clearing obligation would cease to apply upon the FC's notification to ESMA and the FC's national competent authority such that no further action is necessary from the FC for the clearing obligation to cease to apply to it. As part of its notification, we think it reasonable to require the FC to provide evidence of its volumes of OTC derivatives transactions. In addition, the FC's national competent authority would be entitled to investigate further if it considered necessary, in line with such authority's general supervisory powers.

MFA's concern is that, without such a clear and simple requirement, it could lead to uncertainty for the FC. Specifically, once an FC ceases to be subject to the clearing obligation, any transactions the FC concludes after such time will be non-centrally cleared contracts that are subject to the EMIR Margin Rules. In the absence of an FC having certainty as to whether it has demonstrated to its national competent authority that it has ceased to exceed the clearing threshold, the FC will have uncertainty as to whether or not it remains subject to EMIR's clearing obligation or instead should be complying with the EMIR Margin Rules. We wish to ensure that no FC is in a position of uncertainty. As a result, amending the evidence requirement so that it is instead a notice requirement would reduce the uncertainty for the FCs and the burden on ESMA and each national competent authority to verify an FC's assertion that it is below the clearing threshold.

Article 6: ESMA's Public Register

MFA requests that the Commission work with ESMA to improve the comprehensiveness and usefulness to market participants of ESMA's public register by requiring national competent authorities to provide ESMA on an ongoing basis with detailed information on all of the products that CCPs are authorized to clear, and require ESMA to publish this information in its public register.

At present, ESMA does not include certain OTC derivative products in the public register. In particular, the public register maintained by ESMA includes OTC derivatives products that are:

(1) Products that a CCP is authorized to clear upon its initial authorization under Article 1 of EMIR; and

(2) Products that a CCP is authorized to clear upon an authorization of an extension of its services or activities under Article 15 of EMIR, and that are made subject to the clearing obligation.

However, the public register does not include OTC derivatives products that are not subject to the clearing obligation, or that are not under review by ESMA for this purpose under the 'top-down' review process in accordance with under Article 5(3) of EMIR. Moreover, ESMA may not even receive complete information from a national competent authority on the products that a CCP is authorized to clear because, in certain circumstances, a national competent authority is not required to provide such information under Article 5(1) of EMIR.[37]

Therefore, there are limits on the information available to ESMA, and thereby, to market participants via the public register with respect to the products that EU CCPs are authorized to clear. Accordingly, the gaps in information that is available to clients and other market participants through the public register may impede their ability to make informed choices about what derivatives products are available for them to clear, and where they are able to clear those products. This lack of information also affects ESMA's ability to coordinate effectively the supervision of CCPs. Indeed, MFA notes that ESMA highlighted the limitations in the usefulness of the public register in its own response to the Commission's review of EMIR and advocated for an improved process whereby this additional information would become available.[38]

To address the deficiencies in the public register, MFA strongly recommends that the Commission amend EMIR to require national competent authorities to provide ESMA with detailed information on all of the products that CCPs are authorized to clear on an ongoing basis, and require ESMA to publish this information in its public register.

Article 9: Trade Reporting

A. Dual-Sided Reporting

MFA appreciates the Commission's efforts to reduce the burdens for market participants related to the reporting obligation in Article 9 of EMIR by proposing amendments that would allow single-sided reporting in a number of circumstances. However, MFA strongly urges the EU Authorities to reconsider a number of aspects of its proposal, in particular by amending the reporting hierarchy so that in a trade between a dealer that is an FC and an AIF that is an FC, only the dealer FC is required to report the transaction.

[37] Article 5(1) of EMIR relates to the clearing obligation procedure and provides that "[w]here a competent authority authorises a CCP to clear a class of OTC derivatives under Article 14 or 15, it shall immediately notify ESMA of that authorisation".

[38] *See* EMIR Review Report no.4: ESMA input as part of the Commission consultation on the EMIR Review, Section 4, available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1254_-_emir_review_report_no.4_on_other_issues.pdf.

MFA strongly supports measures that enhance transparency in the derivatives market, including the mandatory reporting of all derivative transactions to TRs. However, MFA considers that the significant challenges encountered by market participants in the implementation of EMIR's dual-sided reporting obligation demonstrate that dual-sided reporting has not operated as intended and justify the Commission permitting single-sided reporting.

The difficulties associated with dual-sided reporting are numerous. For example, it places a significant burden on smaller clients that do not have the necessary infrastructure in place to report their derivative transactions directly to TRs. Such clients are compelled to put in place reporting delegation agreements with their various counterparties that differ in scope, are non-negotiable, and contain onerous provisions. In addition dual-sided reporting creates difficulties for the reporting of intragroup transactions because delegation agreements typically do not provide for the reporting of a client's intragroup transactions, and either do not provide for daily reporting of trade valuations and collateral data or do not provide for such reporting in a manner clients consider to be consistent with EMIR's requirements. Furthermore, it is widely acknowledged that, where both parties to a transaction report separately and potentially to different TRs, the TRs have difficulty matching reports, and thus, the rates of matched trades remain low. These issues affect the accuracy of data available to regulators.

Therefore, MFA appreciates the Commission's reconsideration of single-sided reporting and proposed amendments to allow single-sided reporting in certain circumstances. Below are our views and recommendations on certain aspects of the Commission's proposed single-sided reporting regime.

(i) Reporting of Cleared OTC Derivative Contracts by CCPs alone

MFA applauds the Commission's proposal to require CCPs alone to report exchange-traded derivatives. Nonetheless, MFA considers that the Commission should require CCPs alone to report all derivative contracts that the CCP clears.

Under the EU's principal-to-principal client clearing model, there are two separate transactions: (1) a transaction between the CCP and the client's clearing member; and (2) a transaction between the client's clearing member and the client. MFA believes that the Commission should require the CCP to be the reporting party and to submit a single report in respect of the arrangement. Although in such a report the CCP would need to show the details related to the client's clearing member, we do not believe that the EU Authorities should require the clearing member to submit a separate report in respect of the transaction between itself and the CCP. As noted above, we believe that duplicative reporting affects the accuracy of data available to regulators, and is unnecessary. In addition, we believe that requiring solely the CCP to report the two transactions most accurately reflects the economic reality that, in a principal-to-principal clearing arrangement, the CCP is the entity best placed to submit the report.

(ii) Reporting by Third Country CCPs

MFA would appreciate it, if the EU Authorities would clarify that, where market participants enter into exchange-traded derivatives or cleared derivative contracts using recognized third country CCPs, the third country CCP should report such contracts.

In the EMIR Amending Regulation, the Commission proposes to require each CCP to report transactions that the CCP clears to a TR on behalf of both counterparties to the transactions.[39] In the case of EU CCPs, it is clear that the Commission is imposing the reporting obligation on such EU CCPs, rather than the counterparties. However, it is unclear whether this reporting obligation applies in the case of transactions that are cleared by third country CCPs that are authorized or recognized in the EU.

MFA believes that subjecting recognized third country CCPs to the same requirements as EU CCPs would be proportionate in this instance. Given that such third country CCPs benefit from the EMIR recognition regime, and thus, are able to provide clearing services within the EU in the same way as authorized EU CCPs, MFA believes that, like for EU CCPs, the Commission should similarly require such third country CCPs to report all OTC derivative transactions cleared through them. Further, authorized or recognized third country CCPs are, by their nature, global CCPs. As such, these third country CCPs are sophisticated entities that are as capable as EU CCPs of providing the required EMIR reporting services with minimal additional cost or burden.

Therefore, MFA would appreciate it if the EU Authorities would clarify that the proposed amendments imposing the reporting obligation on CCPs with respect to the trades that the CCPs clear apply equally to EU CCPs and third country CCPs authorized or recognized in the EU.

(iii) Single-Sided Reporting for AIFs

MFA strongly urges the EU Authorities to revise the proposed single-sided reporting regime so that, in a trade between two FCs where one FC is a dealer and the other FC is a client (such as an AIF), only the dealer is required to report the trade.

In the EMIR Amending Regulation, the Commission proposes to permit single-sided reporting for cleared transactions as well as transactions between an FC and an NFC, where the NFC is not subject to the conditions referred to in the second paragraph of Article 10(1) of EMIR, commonly known as a NFC-.[40] However, where both parties are FCs, the Commission is still proposing to require both parties to report the transaction.[41] Moreover, in the EMIR Amending Regulation, the Commission added language specifically providing that the manager of an AIF is responsible and liable for reporting the AIF's transactions.[42]

Currently, under EMIR, clients (such as AIFs) are classified as either FCs or NFCs. However, given the Commission's proposed definition of "financial counterparty" discussed above, in the case of AIFs, all AIFs going forward would be FCs. As a result, while some AIFs may currently be classified as NFC-s, and thus, would be able benefit from the proposed single-sided reporting when trading with an FC, under the Commission's proposed amendments, all AIFs (regardless of how small) would be subject to the reporting obligation. Moreover, because the Commission's proposed definition of "financial counterparty" (as drafted) would apply to all AIFs worldwide, the combined effect of that definition with the dual-sided

[39] *See* EMIR Amending Regulation at 27, Article 1(7)(b), inserting paragraph 1a(a) into EMIR Article 9.

[40] *See id.* at 28, inserting paragraph 1a(b) into EMIR Article 9.

[41] *See id*. at 27, amending paragraph 1 of EMIR Article 9.

[42] *See id*. at 28, inserting paragraph 1a(9) into EMIR Article 9.

reporting obligation for all FCs, is that all AIFs everywhere in the world being subject to the EMIR reporting requirement and having to report all of their transactions in the EU to a TR.

MFA strongly urged the Commission to adopt a single-sided reporting regime in its response to the EMIR review.[43] In addition, MFA continues to believe that a single report in respect of a single derivative contract would be beneficial to all parties because it would eliminate the problems associated with matching reports for TRs and would alleviate the large administrative, operational, and costs burden for our members.

Adopting a single-sided reporting requirement for all transactions subject to EMIR that includes a reporting hierarchy whereby in a transaction between a dealer and a client, the dealer is responsible for the reporting, would also facilitate international convergence between the reporting obligations in the EU and the U.S.[44] For example, in the U.S., the CFTC has implemented a reporting hierarchy as part of its final reporting rules that requires the more sophisticated counterparty to report the transaction.[45] In simplified terms, the CFTC's approach provides that:

(1) In a trade between a dealer and a non-dealer, the dealer must report;

(2) In a trade between a financial entity that is not a dealer and a non-financial entity that is not a dealer, the financial entity must report; and

(3) In a trade where both parties are either dealers, financial entities that are not dealers, or non-financial entities that are not dealers, the parties must agree who will be the reporting party.[46]

EU Authorities could similarly achieve such an approach under EMIR by providing a defined reporting hierarchy under Article 9(1a), whereby the EU Authorities would impose the reporting obligation on the more sophisticated counterparty to the transaction. Specifically, MFA believes that the following three-tier hierarchy would be appropriate:

(1) Where one counterparty is authorized as either as an investment firm ("**IF**") under MIFID II[47] or a credit institution ("**CI**") under CRR,[48] and the other counterparty is neither an IF or CI, then the IF or CI would be the reporting counterparty.

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[43] *See* MFA response to Commission Public Consultation on Regulation (EU) No. 648/2012 on OTC Derivatives, Central Counterparties and Trade Repositories, dated August 13 2015, at 18, Answer to Question 2.3, , available at: https://www.managedfunds.org/wp-content/uploads/2015/08/European-Commission-EMIR-Review-Final-MFA-Consolidated-Response-and-Cover-Letter.pdf.

[44] *See* CFTC final rule on "Swap Data Recordkeeping and Reporting Requirements", 77 Fed. Reg. 2136 (Jan. 13, 2012), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2011-33199a.pdf.

[45] *See id*.

[46] *See id*. at 2207, § 45.8 Determination of which counterparty must report.

[47] *See* Directive 2014/65/EC of the European Parliament and of the Council, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0065&from=EN.

[48] *See* supra note 13.

(2) Where both counterparties are either a CI or IF, but where only one counterparty is a clearing member within the meaning of EMIR, then the clearing member would be the reporting counterparty.

(3) Where both counterparties are clearing members, then a tiebreaker logic would apply to determine which counterparty would report, such as the method for determining the transaction seller under Article 3a of the EMIR reporting implementing technical standards.[49] This logic is already being implemented across the EU with respect to reporting, and thus, serves as an efficient proxy for determining the responsible reporting counterparty as a last resort.

MFA believes that the foregoing approach is easily implementable and understandable, and thinks it would be appropriate for the EU to adopt a similar reporting hierarchy for EMIR. This approach is also widely supported among market participants in the financial services industry, and in April 2016, MFA jointly completed a white paper with 11 other trade associations expressing support for, and explaining the benefits of such an approach.[50]

In addition, to ensure that the benefit of such a single-sided reporting regime would be available to clients when transacting OTC derivatives with non-EU dealers, MFA believes that clients should not be subject to EMIR reporting requirements when transacting with non-EU dealers.[51] In particular, we believe that this exclusion should apply only to the extent that the client has entered into a legally binding agreement with the non-EU dealer whereby the client delegates its reporting responsibilities to the non-EU dealer. MFA understands that the supervisory powers of EU Authorities do not generally extend to non-EU dealers. Therefore, requiring non-EU dealers to undertake reporting for both counterparties under EMIR would be beyond the scope of what competent authorities can reasonably monitor and enforce. However, we expect that these transactions would be subject to reporting requirements in the non-EU dealers' jurisdiction of organization, and that (as discussed further below) EU authorities would have access to the data reported with respect to such transactions. Also, by limiting the exclusion to delegated reporting relationships subject to a legally binding agreement, the EU Authorities would be reducing the burdens on markets participants by eliminating duplicative and unnecessary reporting requirements. This benefit would be especially important for smaller market participants transacting with non-EU dealers, because many smaller market participants do not have the infrastructure to report for themselves, and thus, must rely on such delegated reporting relationships to comply with their reporting requirements.

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[49] *See* Commission Implementing Regulation (EU) 2017/105 of 19 October 2016, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0105&from=EN .

[50] *See* Joint Trade Association Whitepaper on "Improving Derivatives Transparency: The Merits of an Entity-based Reporting Framework", dated April 2016, available at: https://www.managedfunds.org/wp-content/uploads/2016/04/Joint-Trade-Paper-re-Improving-Regulatory-Derivatives-Transparency-Final-4-13-16.pdf.

[51] MFA notes that the delegation agreement could be made available to EU authorities for inspection upon request. The EU Authorities could achieve such an approach by providing under Article 9(1a) of EMIR that, where a non-EU dealer that if it were established in the EU would be a CI or IF, is a counterparty to a derivative transaction and its EU counterparty is not a CI or IF, the EU counterparty would be subject to the reporting requirement only where no legally binding delegated reporting agreement is in place between the EU counterparty and the non-EU dealer.

Moreover, MFA believes that ensuring international convergence as it relates to the reporting obligation is of great importance and necessity. As proposed in the EMIR Amending Regulation, sharing of data collected by TRs will occur not only among EU authorities, but also on a cross-border basis with third country authorities across the globe.[52] For authorities to be able to analyze shared data efficiently and use that data to address potential issues of systemic risk, it is important that the data collected not be duplicative. Collection and sharing of duplicative data increases the likelihood of errors and inconsistencies in the data reported as well as the potential for data to be taken into account twice, thereby inflating risk metrics and skewing the results of the data analyzed.

Furthermore, MFA emphasizes that moving to single-sided reporting will not reduce data quality or result in a failure by market participants to agree and reconcile the terms of their transactions because the risk mitigation techniques that market participants have implemented under Article 11 of EMIR provide for appropriate timely confirmation, reconciliation, dispute resolution, and portfolio valuation arrangements. MFA also continues to believe that the introduction of a single-sided reporting regime of the kind we are recommending would not result in significant additional costs for the market in the long term, when compared to the ongoing costs that will be involved for firms with a dual-sided reporting regime. In particular, ongoing costs arise from market participants continuing to: (i) offer and document delegated reporting services; (ii) address client queries; (iii) attempt to reconcile reports; and (iv) attempt to check data reported on their behalf.

Accordingly, MFA urges refinement of the EMIR Amending Regulation to implement a single-sided reporting regime that prescribes a hierarchy for single-sided reporting such that, in all instances, the more sophisticated counterparty to a transaction is required to report a derivative contract. To clarify who is responsible for the reporting under such regime, we would recommend that EMIR incorporate a reporting hierarchy based on the principle that the more sophisticated party is responsible for reporting it. In particular, we believe that the most efficient method to accomplish the goal of timely transaction reporting in trades between a dealer and a client (such as an AIF) is by requiring the dealer to report, since dealers already have established robust transaction reporting systems and have customarily provided transaction confirmations or reports to clients. Clients, on the other hand, generally do not have reporting systems in place and requiring them to establish such systems would be costly and inefficient when there is a dealer alternative.

MFA continues to recognize that, in the case of cross-border transactions, the more sophisticated counterparty may be a third country entity ("**TCE**") that is not subject to EMIR, and thus, cannot be made to comply with the EMIR reporting obligation. In such circumstances, we would expect the reporting obligation to reside with the EU counterparty, which undoubtedly would still be able to delegate reporting of the transaction to the TCE, as happens presently

(iv) Managers to Report for AIFs/Management Companies to Report for UCITS

MFA requests that the EU Authorities provide additional clarification regarding two aspects of the proposals in Article 9(1a)(c) and (d) of EMIR requiring the management company of a

[52] *See* EMIR Amending Regulation at 31-2, Article 1(15) and (17), inserting Article 76a into EMIR and amending Article 81 of EMIR.

UCITS to report on behalf of the UCITS, and for the manager of an AIF to report on behalf of the AIF.

Generally, where either an AIF or a UCITS is trading with a dealer counterparty, MFA strongly supports a single-sided reporting regime, as outlined above, such that the dealer counterparty alone will report for both parties. Notwithstanding this view, MFA notes two issues with the proposed operation of Article 9(1a)(c) and (d) of EMIR.

First, under Article 9(1a)(c) of EMIR, it is necessary for the Commission to address who must report a UCITS's transactions when a UCITS does not have a management company. The EMIR Amending Regulation assumes that every UCITS has a management company to complete the reporting on the UCITS behalf. However, MFA notes that UCITS are not required to have a management company, and thus, it remains unclear who the Commission wants to do the UCITS reporting in such situation. MFA expects that, in such case, the Commission intends for the UCITS to report on behalf of itself under Article 9 of EMIR, but it would be helpful if the EU Authorities clarified this issue.

Secondly, with respect to the reporting hierarchy in Article 9(1a)(d) of EMIR, we refer to our previous comments regarding the Commission's stated objective in amending the definition of "financial counterparty". We assume that the Commission would require an AIFM that is authorized or registered under AIFMD to report on behalf of any AIF that it manages.[53] However, where an AIF is established in the EU but not managed by an AIFM authorized or registered under AIFMD,[54] it remains unclear who is responsible for reporting on behalf of the AIF, since the EU may not have authority over the AIF's manager to mandate that they report on behalf of the AIF. Here again, MFA expects that in such case the Commission intends for the EU AIF to report on behalf of itself. Nevertheless, again, it would be helpful for the EU Authorities to clarify this issue.

(v) Reporting of Intragroup Transactions

MFA applauds the Commission's proposal to eliminate the reporting obligation for intragroup derivative contracts (*i.e.*, contracts between two parties that are part of the same group) where one of the parties is an NFC. However, MFA supports the Commission extending this reporting exclusion to all intragroup derivative contracts, not merely those contracts where one of the parties is an NFC. Given that the administrative burden involved in reporting these contracts far outweighs the risk posed by such transactions to the financial markets, MFA recommends that no intragroup transactions be subject to the EMIR reporting regime.

B. Backloading Obligation

MFA applauds the Commission's proposal to revise Article 9 of EMIR to eliminate the requirement for FCs and NFCs to report Terminated Transactions (as defined below) by 17 February [2019]. Therefore, we support retention of the proposed amendment to Article 9 in the final EMIR text.

[53] *See* scenarios (1) and (2) described above in our response headed "Treatment of AIFs".

[54] *See* scenario (3) described above in our response headed "Treatment of AIFs".

MFA notes that, under the current EMIR RTS related to counterparties' reporting of trades to TRs,[55] FCs and NFCs must report Terminated Transactions[56] to a TR by 12 February [2019]. MFA has consistently expressed its concern that this requirement would impose a significant administrative burden on many market participants (*i.e.*, all FCs and NFCs), but would not provide any benefit to regulators or the financial markets.[57]

In particular, MFA has been of the view that this requirement would result in market participants reporting an enormous volume of Terminated Transactions. In many cases, it would also necessitate such market participants having to implement new documentation, procedures, and infrastructure to self-report, given that many reporting delegation agreements do not provide for the reporting of Terminated Transactions. It would be both administratively burdensome and costly for market participants to report these Terminated Transactions. In addition, we find it difficult to understand how data relating to transactions that will have terminated more than [five] years before the data is reported will assist national regulators or ESMA in reducing systemic risk.

MFA, therefore, appreciates the Commission's proposal to revise Article 9 of EMIR to eliminate the backloading requirement, and encourages retention of this amendment in the final EMIR text.

Article 13: Equivalence under EMIR

MFA urges the Commission to clarify that, for purposes of relying on equivalence acts under Article 13 of EMIR, an entity is deemed "established" in a third country if it is either legally incorporated in and/or subject to regulation in that third country.

Pursuant to Article 13 of EMIR, the Commission may adopt an implementing act declaring that the legal, supervisory and enforcement arrangements of a third county are equivalent to EMIR's requirements set out in Article 4 (clearing), Article 9 (record-keeping and trade reporting), Article 10 (NFCs) and Article 11 (risk mitigation techniques). Where the Commission adopts such an act, counterparties that enter into a transaction subject to EMIR are deemed to have fulfilled their obligations under Articles 4, 9, 10 and 11 of EMIR, if they comply with the third country's equivalent rules and at least one of the counterparties is "established" in that third country.

The notion of being "established" in a jurisdiction and the related equivalence determinations present difficulties for the funds industry and their EU counterparties. Many funds are legally incorporated outside the U.S.; However, because these funds are managed by U.S.-based investment managers (or, under the CFTC's rules, are majority-owned by U.S. persons), such funds are deemed to be U.S. persons ("**U.S. Offshore Funds**") and are required to comply with

[55] *See* Commission Implementing Regulation (EU) No 1247/2012 of 19 December 2012 laying down implementing technical standards with regard to the format and frequency of trade reports to trade repositories according to Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories (as amended by Commission Implementing Regulation (EU) 2017/105 of 19 October 2016, Article 5(4), available at: http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017R0105&from=EN.

[56] *See supra* note 10.

[57] *See supra* note 43.

U.S. rules.[58] Thus, when U.S. Offshore Funds enter into derivatives trades with EU counterparties subject to EMIR, if the Commission does not regard these U.S. Offshore Funds as being "established" in the U.S. for purposes of Article 13, then the U.S. Offshore Funds and their EU counterparties would need to comply with both the EMIR obligations set out in Articles 4, 9, 10 and 11 and the equivalent U.S. obligations.

This duplicative and potentially conflicting regulation would occur despite the fact that the purpose of Article 13 is to prevent counterparties from having to comply with two separate and equivalent regulatory regimes and encountering all of the related compliance difficulties. MFA emphasizes that this fact pattern is reflective of a significant volume of business in the EU derivatives market. Thus, this issue could seriously affect the business of EU banks and U.S. Offshore Funds as they may cease transacting with each other to avoid duplicative or conflicting rules. Such unintended consequences would be contrary to the interests of global trading as well as ease of access to markets. As a result, this issue is as significant an issue for EU banks as it is for U.S. Offshore Funds.

Therefore, the importance of this issue should not be underestimated. MFA urges the EU Authorities to amend the language in Article 13(3) to address this issue by addition of the following underlined wording:

> "An implementing act on equivalence as referred to in paragraph 2 shall imply that counterparties entering into a transaction subject to this Regulation shall be deemed to have fulfilled the obligations contained in Articles 4, 9, 10 and 11 where at least one of the counterparties is established <u>or subject to regulation</u> in that third country."

This approach mirrors the approach taken in the EU under AIFMD, whereby funds established outside the EU but managed by AIFMs authorized or registered in accordance with AIFMD are brought within the legislative framework of AIFMD. Therefore, MFA strongly believes that the foregoing amendment to EMIR is necessary: (i) to address the difficulty that the current lack of clarification creates for many participants in the EU markets; (ii) to prevent market fragmentation resulting from market participants' inability to comply with two conflicting but equivalent regulatory regimes; and (iii) to facilitate convergence across EU regulations with respect to the treatment of AIFs and their unique legal structures.

<u>Article 38(6) and (7): Disclosure of IM Model</u>

MFA supports the Commission's proposal to introduce enhanced transparency on CCP's initial margin ("**IM**") models through its proposed amendments to articles 38(6) and 38(7), and requests that the EU Authorities require CCPs to disclose their IM models not only to clearing members, but also to clients.

In the EMIR Amending Regulation, the Commission proposes to require each CCP to make the relevant simulation tool and information on the CCP's IM model available to its clearing members. MFA agrees that it is important for clearing members to have such transparency because it gives them the ability to anticipate accurately the amount of IM CCPs will require

[58] *See* CFTC "Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations", 78 Fed. Reg., 45292, available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2013-17958a.pdf.

the clearing members post, thereby allowing the clearing members to manage their liquidity more efficiently.

However, MFA strongly believes that it is similarly important for clients to have access and transparency with respect to CCPs' IM models. Clients' IM obligations in respect of cleared OTC derivatives transactions are also invariably based on the CCPs' IM models. Therefore, clients have the same interest as clearing members in being able to anticipate and manage their IM requirements.

As a result, MFA strongly encourages the EU Authorities to expand proposed Article 38(6) and (7), and require CCPs to make their simulation tools and information on their IM margin models available to both clearing members and clients.

Article 39(11): Modification of Insolvency Laws

MFA applauds the Commission's proposal to include Article 39(11) of the EMIR Amending Regulation to clarify that both assets and positions held in accounts at a CCP will not be considered part of the insolvency estate of the CCP or a clearing member. Therefore, we support retention of the proposed amendment to Article 39(11) in the final EMIR text.

MFA has strongly advocated for the protection of clients and their collateral because such protections are one essential element to preserving the financial integrity of the markets. In the U.S., we were very troubled by the regulatory issues revealed by the insolvencies of MF Global, Inc. and Peregrine Financial Group, Inc. The misuse or misplacement of client funds in those situations resulted in clients experiencing a delay in the return or loss of substantial amounts of their assets.[59] As a result, MFA greatly appreciates that the Commission recognizes the importance of protecting clients and their collateral, and thus, is proposing to mandate that segregation arrangements with respect to centrally cleared derivatives contracts provide clients with certainty that their collateral will be insolvency remote from the failure of CCPs and their clearing members.

Article 81(3a): Access to TR Data

MFA applauds the Commission's proposal to require TRs to provide counterparties and CCPs with the information reported on their behalf to TRs, and have the following three recommendations to enhance the robustness of this requirement:

(1) We request that the EU Authorities clarify that Article 81(3a) permits TCEs to access data reported by their counterparties to an EU TR about the TCEs' derivatives transactions.

[59] *See* Complaint, U.S. Commodity Futures Trading Commission v. Peregrine Financial Group, Inc., and Russell R. Wasendorf, Sr., No. 12–cv–5383 (N.D. Ill. July 10, 2012), available at: http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfpfgcomplaint071012.pdf. *See also* Report of the Trustee's Investigation and Recommendations, In re MF Global Inc., No. 11– 2790 (MG) SIPA (Bankr. S.D.N.Y. Jun. 4, 2012), available at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/mfglobaliinvestreport060412.pdf.

(2) Because our concerns are high about the risk and threat of cyberespionage and data security, we urge the EU Authorities to enhance the required policies and procedures for protection of such information.

(3) We urge the EU Authorities to ensure that, where counterparties execute a transaction on an anonymous basis on a regulated market, MTF, or OTF (collectively, "**EU Trading Venues**") and then clear that transaction, Article 81(3a) would not permit one party to access data from a TR related to the identity or LEI of its original counterparty or its original counterparty's clearing member.[60]

First, MFA strongly supports increasing transparency in the derivatives markets, and in particular, with respect to the transaction data reported to TRs. Many of our members have entered into delegated reporting arrangements for purposes of complying with their reporting obligation under EMIR. However, our members have faced difficulty in accessing information held at TRs, which has made it difficult for our members to confirm that data reported on their behalf is accurate. Given that many TCEs are subject to the EMIR reporting obligation by virtue of trading with EU counterparties, we think it important that these TCEs also have access to data reported to TRs on their behalf. Therefore, we would appreciate it if the EU Authorities would clarify that access to TR data under Article 81(3a) also applies to TCEs (*i.e.*, entities not established in the EU) whose counterparties have reported the TCEs' derivatives transactions to an EU TR.

Second, MFA believes that the EU Authorities should strengthen the confidentiality protections in Article 81(3a) applicable to TRs and EU authorities in respect of confidential information held by EU TRs. Since the implementation of EMIR reporting requirements in 2014, the global threat of cyber espionage and cyber-attacks has increased and continued to grow. We support authorities in the EU and other jurisdictions having the information they need to oversee registrants and to surveil markets. However, we remained concerned that vulnerabilities in information security will jeopardize not only market participants and their investors, but also the EU economy through the loss of domestic trade secrets and confidence in the integrity of the regulatory framework. Therefore, we believe it is imperative that EU authorities seek to combat this increased threat to data security by enhancing the protections and safeguards for confidential, sensitive, and proprietary information under EMIR.

Specifically, MFA would urge the EU Authorities to require TRs to have enhanced policies and procedures in place to protect the data that they collect. In addition, we urge the European Parliament and the Council to restrict the extent to which EU and third country authorities may request and/or access highly confidential or proprietary information (whether held in EU TRs or by the market participants directly), and permit such access only when absolutely necessary to fulfill their regulatory mandates. Moreover, where EU and third country authorities access such confidential or proprietary data, we strongly recommend that the European Parliament and the Council impose an information security policy in which the protections and security requirements are heightened or tiered depending upon the level of sensitivity of the data collected, including how to dispose of or return the data.

[60] MFA has previously urged the Commission to take precautions with respect to confidential information in other contexts. *See* MFA letter to the Commission on its consultation document "Fintech: A more competitive and innovative European financial sector", dated June 15, 2017, available at: https://www.managedfunds.org/wp-content/uploads/2017/06/MFA-Letter-to-EC-on-FinTech-Consultation.pdf.

Third, MFA respectfully requests that the EU Authorities ensure that, where counterparties execute a transaction on an anonymous basis on an EU Trading Venue and then clear that transaction, the identifying information of those counterparties would remain anonymous. Accordingly, we respectfully urge the EU Authorities to revised proposed amended Article 81(3a) to make clear that one party may not have access to data from a TR related to the identity or LEI of its original counterparty or its original counterparty's clearing member. In the U.S., the CFTC has rules similar to proposed amended Article 81(3a), which allow any counterparty to a transaction to access data and information related to that transaction maintained by a swap data repository ("**SDR**") (*i.e.*, the U.S. equivalent of TRs).[61] However, MFA and other market participants raised concerns that the CFTC's SDR rules could result in inadvertent post-trade disclosure of the identities and LEIs of counterparties to anonymously executed derivatives trades. In response to these concerns, the CFTC adopt an interim final rule, which explicitly protected the identities of counterparties to anonymously executed, cleared derivatives transaction by stating that:

> When a swap is executed anonymously on a swap execution facility ("SEF") or designated contract market ("DCM") and then cleared in accordance with the Commission's straight-through processing requirements—such that the counterparties to the swap would not otherwise be known to one another—the identity of each counterparty to the swap and its clearing member for the swap, as well as the [LEI] of such counterparty and its clearing member, is information that is private vis-à-vis the other counterparty to the swap, and this privacy must be maintained by a registered SDR pursuant to [U.S. Commodity Exchange Act] section 21(c)(6).[62]

MFA strongly believes that trades executed on an anonymous basis should remain anonymous even after reported to a TR. We do not believe that there is any legitimate business reason for any party to an anonymously executed, cleared derivatives transaction to obtain information regarding the identity or LEI of the other original transacting counterparty or that original counterparty's clearing member. Such disclosure could inappropriately reveal a counterparty's proprietary information, including investment positions or trading strategies. Moreover, the prospect of such disclosure could undermine the evolution of anonymous trading on EU Trading Venues.

Therefore, to ensure the protection of private trading and identifying information related to transactions executed anonymously on EU Trading Venues, we encourage the EU Authorities to adopt an approach for EMIR similar to the CFTC's approach in the U.S. by limiting a party's ability to access identifying data maintained by a TR related to its original counterparty or that original counterparty's clearing member.

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[61] *See* CFTC final rule on "Swap Data Repositories: Registration Standards, Duties and Core Principles", 76 Fed. Reg. 54538 (Sept. 1, 2011), at 54582, Section 49.17(f)(1), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2011-20817a.pdf.

[62] CFTC interim final rule; request for comment on "Swap Data Repositories—Access to SDR Data by Market Participants", 79 Fed. Reg. 16672 (Mar. 26, 2014), available at: https://www.gpo.gov/fdsys/pkg/FR-2014-03-26/pdf/2014-06574.pdf.

Article 85(1): Further EMIR Review

MFA supports the mandate for the Commission to evaluate EMIR further and prepare a general report for submission to the European Parliament and the Council, together with any appropriate proposals.

In particular, MFA considers that the Commission should conclude an evaluation of EMIR's Margin Rules and we would welcome a review of such rules sooner than the three-year period suggested in the EMIR Amending Regulation.