Managed Funds Association

AIMA

European Commission
Rue de Spa 2
1000 Bruxelles
Belgium

By online submission: www.ec.europa.eu

7 April 2021

Feedback on draft delegated regulation on commercial standards for central clearing services under EMIR

Dear Sir or Madam,

The Alternative Investment Management Association[1] ("AIMA") and Managed Funds Association[2] ("MFA"; collectively, the "Associations") welcome the opportunity to respond to the European Commission (the "Commission") regarding its draft delegated regulation on commercial standards for central clearing services under EMIR[3] (the "delegated act").

The Associations support the objectives that underlie the clearing obligation under Article 4 of EMIR and welcome moves to facilitate access to clearing for clients that have limited volume of activity in the OTC derivatives market and face difficulties in accessing central clearing. As such, we strongly support the change made to Article 4 as part of the EMIR Refit[4] package to require clearing members

[1] AIMA is the global representative of the alternative investment industry, with more than 1,900 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programs and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council ("ACC") to help firms focused in the private credit and direct lending space. The ACC currently represents over 100 members that manage $350 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialized educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors).

[2] MFA represents the global alternative investment industry and its investors by advocating for public policies that foster efficient, transparent, fair capital markets, and competitive tax and regulatory structures. MFA supports member business strategy and growth via proprietary access to subject matter experts, peer-to-peer networking, and best practices. MFA's more than 140 member firms collectively manage nearly $1.6 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has a global presence and is active in Washington, London, Brussels, and Asia, supporting a global policy environment that fosters growth in the alternative investment industry.

[3] Online at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12343-An-act-specifying-when-commercial-terms-of-central-clearing-are-fair-reasonable-non-discriminatory-and-transparent-

[4] Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-

and clients which provide clearing services to provide those services under "fair, reasonable, non-discriminatory and transparent ("FRANDT") commercial terms. We believe that, taken together with other legislative changes such as developments under the Capital Requirements Regulation,[5] which have clarified the treatment of client margin posted on centrally cleared derivatives positions, the FRANDT requirements have the potential to improve significantly the access of buy-side market participants to central clearing and the terms under which such access is provided.

The Associations welcome the Commission's aim to provide greater clarity in respect of the conditions under which commercial terms are considered to be FRANDT. In particular, we welcome actions to implement the FRANDT concept through Level 2 measures to ensure its effectiveness. We are generally pleased with the Commission's impact assessment and policy choices for the delegated act. However, there are a few areas where we would encourage further consideration. These relate to the scope of the FRANDT requirement; transparency of commercial terms and on-boarding process; and contractual terms.

Scope

The Associations believe that the scope of the obligation to apply FRANDT terms should not be restricted to transactions covered by mandatory clearing under EMIR – that is, where both the OTC derivatives contract and counterparties to that are subject to the clearing obligation. We believe that limiting the scope in this way does not follow the Commission's objective to facilitate access to clearing for clients that have limited volume activity in the OTC derivatives market. Many smaller clients with limited trading volumes are not subject to the EMIR clearing obligation due to the exemption for small financial counterparties, as set out under the EMIR Refit. Thus, restricting the scope to transactions subject to the clearing obligation would act as a barrier to smaller financial counterparties that wish to have access to central clearing on FRANDT terms, while disproportionately supporting larger financial counterparties.

We believe that the Commission should widen the scope of the obligation to apply FRANDT terms to all cleared OTC derivatives transactions. This would facilitate a level playing field for clients that wish to access central clearing while encouraging voluntary clearing.

Transparency of commercial terms and on-boarding process

The Associations support the Commission's proposals to facilitate the transparency of commercial terms and on-boarding process. We believe that it is critical that both the commercial terms offered to clients and the on-boarding process are fair and transparent. As such, we welcome the Commission's proposals to require clearing service providers to disclose information on key commercial terms to prospective clients and provide both a high-level description of the on-boarding process and form for a request for proposal on their websites, with minimum elements specified in the delegated act. We believe that this would help smaller or inexperienced clients to access central clearing and encourage more efficient and fairer negotiations.

However, in order to ensure full fairness and transparency, we believe that the Commission should also include in the delegated act clear requirements around conflicts of interest. As noted in our

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. Online at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0834&from=EN

[5] Online at: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32013R0575&from=EN

response to ESMA's consultation paper on draft technical advice on commercial terms for providing clearing services under EMIR[6], we believe that the delegated act should explicitly prohibit trading personnel from interfering with or attempting to influence decisions by clearing personnel around the commercial terms offered to a client or whether to on-board the client. Level 1 text already includes a prohibition on conflicts of interest as it relates to the FRANDT concept[7] thus imposition of a requirement in the Level 2 measures would be consistent and reinforce the prohibition. A Level 2 requirement would also be in line with the internal conflicts of interest requirements that clearing members are obliged to comply with in other jurisdictions, notably the US.[8]

Contractual terms

The Associations support requirements to ensure that contractual terms are FRANDT. While we agree that a prescriptive approach that indicates the types of clauses that are or are not permitted may be rigid and unfeasible, we believe that the delegated act should stipulate that clearing terms offered by clearing members should not contain terms that unnecessarily reduce clients' rights relating to cleared derivatives as compared to uncleared derivatives. In particular, clients should not be limited in their rights to make a claim against their clearing members for losses that clients incur in the event that, for example, their clearing member is declared in default. We believe that inclusion of such a stipulation in the delegated act would promote reasonable commercial terms and unbiased and rational contractual arrangements.

Our concern in this regard is due to the terms of the standard industry document published by International Swaps and Derivatives Association ("ISDA") and the Futures Industry Association ("FIA") for cleared derivatives, the ISDA/FIA Client Cleared OTC Derivatives Addendum (the "Addendum")[9]. The Addendum provides that if a clearing member defaults and derivatives held by the clearing member in respect of a client are terminated by the clearing house without being transferred, the amount that the client may claim from the clearing member is not the amount of loss that the client suffers, but is instead the amount at which the clearing house terminates the related derivatives[10]. This approach exposes the client to bid-offer spreads and the risk of market moves, both of which could be material if a significant clearing member defaults. The failure of the Addendum to allow clients to claim for their losses significantly increases their counterparty exposure risk through the use of cleared derivatives over uncleared derivatives, as the standard ISDA master agreement allows clients to claim for such losses in the event of a dealer default. Such terms create disincentives for clients to clear derivatives.

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[6] Online at: https://www.esma.europa.eu/press-news/consultations/consultation-draft-technical-advice-commercial-terms-providing-clearing

[7] See Article 4(3a) of the EMIR Refit text. Online at: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32019R0834&from=EN

[8] *See* US Commodity Futures Trading Commission final rules on "Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants", 77 Fed. Reg. 64 (April 3, 2012). Online at: https://www.govinfo.gov/content/pkg/FR-2012-0 4-03/pdf/2012-5317.pdf

[9] See here for a link to the Addendum: https://www.isda.org/book/isdafia-client-cleared-otc-derivatives-addendum-eu-principal-to-principal-arrangements/

[10] Section 8(b) of the Addendum sets out the approach for a clearing member default. Section 8(b)(ii)(2) provides that the transactions are to be valued at the "CM/CCP Transaction Value". The CM/CCP Transaction Value is defined in Section 20 of the Addendum to equal the amount that the clearing house ascribes to the terminated transactions.

We urge the Commission to clarify that it is inconsistent with FRANDT commercial terms for clients to be limited in their rights from making claims against their clearing members for losses that clients incur. We believe that it is neither fair nor reasonable for standard agreements, such as the Addendum, to limit clients in their ability to seek claims against clearing members for losses.

Overall, we believe that the Commission has approached its impact assessment of the principles associated with the FRANDT concept in a comprehensive and well-considered manner. We encourage the Commission to ensure that this detailed approach is reflected in the final delegated act to ensure a harmonised application of rules across clearing service providers, particularly to smaller clients.

If you would like to discuss any aspect of this submission further, please contact Aniqah Rao (arao@aima.org) and Sarah Ek (sek@managedfunds.org).

Yours truly,

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