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30 April 2020

Dear Executive Vice-President Dombrovskis,

Dear Chairman Maijoor,

Dear Chairman Campa,

Dear Chairman Bernardino,

EMIR – Time-limited derogation under the Margin Regulatory Technical Standards (Margin RTS) for intragroup transactions

The International Swaps and Derivatives Association (ISDA), European Association of Co-operative Banks (EACB), the European Banking Federation (EBF), the Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA) and the Nordic Securities Association

(NSA, comprising the Danish Securities Dealers Association (Børsmæglerforeningen), Finance Finland (Finanssialan Keskusliitto), the Norwegian Securities Dealers Association (Verdipapirforetakenes Forbund) and the Swedish Securities Dealers Association (Svenska Fondhandlareföreningen) – hereinafter referred to as 'the associations'- welcome the steps that the European Commission and the European Supervisory Authorities (ESAs) have taken so far to ensure that EU derivatives counterparties can rely on the intragroup exemption from margin under EMIR when dealing with non-EU affiliates. However, the associations and their members would like to take this opportunity to emphasise the importance of intragroup transactions both for the ability of EU financial groups to operate, compete (with other financial groups) and make capital available in non-EU jurisdictions and to manage risks on a centralised basis therein. Intragroup transactions are also vital to the ability of non-EU financial groups to provide capital needed to underpin investment within the EU-27, and to manage risk associated with this activity.

We therefore ask both that *1) the necessary equivalence decisions be adopted as a matter of urgency in relation to all jurisdictions that have implemented margin rules in line with the BCBS-IOSCO framework and 2) that the draft revised Margin Regulatory Technical Standards (Margin RTS) should be amended by the European Commission and ESAs such that the current temporary derogation from margin requirements for intragroup transactions with non-EU affiliates be extended for a further 3 years (beyond the extension until 21 December 2020 proposed in the draft Margin RTS) for all other jurisdictions.* Ideally these steps would be taken as soon as possible during the first half of 2020 in order to prevent market participants from having to initiate and execute costly compliance processes, despite the uncertainty around the application or otherwise of this requirement, and the demanding conditions faced by market participants, in relation to the COVID-19 crisis.

Intragroup transactions are crucial for centralised risk management at group level by internationally active EU entities

Intragroup transactions are an essential tool in the ability of financial groups to offer derivatives business across borders. They allow central management of liquidity, which is key to enabling firms to offer the most favourable prices to their clients. The ability of EU investment firms to carry out intragroup transactions without being required to clear or margin those transactions allows EU financial markets to remain competitive. If this was not the case, the collateral cost to EU investment firms would make central risk management models prohibitively costly, and impede investment firms' ability to operate and compete in international derivatives markets. We discuss the reasons for this cost increase further below.

International financial groups operate through a network of subsidiaries and branches, both within the EU and across third-countries. This network allows international groups to operate in different markets, with the various entities and branches facing clients in that locality. However, in order to offer liquidity in multiple jurisdictions, international financial groups need to be able to centrally manage the risk associated with cross border trading.

In the derivatives industry, it is common for risk to be centrally managed. This allows for more efficient hedging and management of the risks that the financial group is exposed to. It also enables the use of central infrastructure, rather than having to build separate systems in each jurisdiction. This is not to say that firms do not manage risk or comply with regulatory obligations in the jurisdiction they are

trading in. Rather, booking models are used which allow effective management of prudential risks to the group, and central management of derivative risk.

The management of this risk is facilitated by trades between group entities. These are not client facing trades, are not price forming, and do not alter the market or credit risk exposure. Rather, they are a block transfer of risk within the group. Client facing trades would remain subject to margin (or clearing) requirements where those trades fall in scope for them.

The counterparties to the intragroup transaction are also subject to an appropriate centralized risk evaluation, measurement and control procedures. In relation to the intragroup exemption from the margin requirements, EMIR requires that the risk management procedures of the counterparties are adequately sound, robust and consistent with the level of complexity of the derivative transaction in question.

Regarding the cost increase mentioned above, this arises for a number of reasons. In particular, the expectation is that firms will have to exchange IM with the majority of their affiliates and that the amount of IM that will need to be exchanged will be a further 25 – 35% of the margin already being exchanged with external clients. This margin would be posted in segregated, bankruptcy-remote, non-rehypothecatable form (meaning that the margin is trapped liquidity or assets which cannot be used for any other purpose). This will increase the funding costs of each firm, as well as imposing an opportunity cost (as the assets cannot be put to more productive use, such as financing real economy activities). There will also be an operational and staff cost, as additional systems and human resource will need to be deployed at affiliates to manage and oversee the margin exchange process and to monitor reporting of margin exchanged.

It is important that the ESAs and EC act quickly to eliminate uncertainty as to whether and to what extent market participants will have to exchange margin in trades between EU and non-EU affiliates from 21 December 2020. If market participants do not receive early clarity, they will need to redeploy internal resources to prepare for implementation which may detract from their role in continuing to provide liquidity to counterparties and clients inside and outside the EU at this critical time. The vital role of financial intermediaries in financing the real economy is clear to market participants and policymakers alike, in the current context. The potential compliance requirements associated with the loss of the intragroup derogation are legally, operationally and financially demanding, however, and will take many months to put in place.

Equivalence decisions should be adopted in relation to all jurisdictions which have implemented BCBS-IOSCO-compliant margin requirements

The associations urge the European Commission to adopt equivalence decisions as soon as possible for all jurisdictions that have implemented margin requirements that aim to comply with the G20's OTC derivative market reform agenda.

The original purpose of the temporary derogation included in the 2016 Margin RTS was to give the European Commission time to adopt equivalence decisions in relation to any relevant third countries. However, while equivalence decisions have been adopted in relation to the US CFTC margin rules and the Japanese margin rules, no other equivalence decisions have yet been adopted. While many jurisdictions only completed implementation of their own margin rules after adoption of the Margin RTS, a significant number of jurisdictions have now had margin rules in force for several years,

including Australia, Brazil, Canada, Hong Kong, Mexico, Singapore, South Korea and Switzerland. The US prudential regulators adopted their margin rules in October 2015. These jurisdictions are important trading partners of the EU and important markets for EU financial institutions. In addition to these jurisdictions, other jurisdictions are also in the process of introducing margin rules, including, in the US, the SEC (whose margin rules will enter into force shortly).

We would welcome confirmation as soon as possible from the European Commission that it is investigating jurisdictions which may have equivalent margin rules and that it is intending to seek technical advice from the ESAs regarding the potential equivalence of the margin rules in the jurisdictions listed above or in any other jurisdictions.

We further add that equivalence should be outcomes-based, and therefore should not be caveated by a long list of conditions relating, for example, to aspects of regulation of derivatives activity where prospective beneficiaries of equivalence would be required to comply with EU regulation rather than the regulation applying in the jurisdiction concerned (where there are differences). Such conditionality has the effect of undermining the benefits of equivalence (by inflating legal and compliance costs). To the extent such conditionality is attached to equivalence decisions, it should focus on the most systemic risk-related aspects of uncleared derivatives business.

Extension of the current derogation

Article 36 of the Margin RTS currently provides that where an EU counterparty and a third country counterparty to a non-centrally cleared OTC derivative contract meet the conditions for an intragroup transaction, and where no equivalence decision has been adopted in respect of the relevant third country, the initial margin requirement shall apply 3 years after the date of entry into force of the Margin RTS. Article 37 provides for a similar derogation in relation to variation margin. The Margin RTS entered into force on 4 January 2017, so the derogation was set to expire on 4 January 2020. On 19 December 2019, ESMA published a Final Report for technical standards amending the Margin RTS to extend the temporary exemption to align it with the exemption for the clearing obligation, so that it will expire from 21 December 2020[1,2]. The ESAs also stated, at that point, that they expected National Competent Authorities to take a 'risk-based and proportionate' approach to enforcement of the margining requirement for intragroup transactions as of 4 January 2020, pending adoption and application of the revised expiry date of 21 December 2020, in the revised Margin RTS.

While the associations welcome this extension of the temporary derogation, we are concerned that it is necessary to extend the temporary derogation further in order to protect EU counterparties which enter into OTC derivatives with non-EU affiliates located in jurisdictions which have not yet adopted margin requirements equivalent to those under the Margin RTS, or potentially also in jurisdictions which have

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[1] https://www.esma.europa.eu/sites/default/files/library/esas_2019_20_-_final_report_-_bilateral_margin_amendments.pdf While these amended technical standards have not yet entered into force, the ESAs have stated, in a Public Statement adopted in December 2019, that they expect competent authorities to apply the EU framework in a risk-based and proportionate manner until the amended technical standards enter into force.

[2] Market participants also believe that regulators should address the time-limited derogation from mandatory clearing of cross-border intragroup transactions (of contracts in classes subject to the clearing obligation) which will also expire on 21 December 2020. See https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0667&from=EN

adopted BCBS-IOSCO-compliant margin requirements but for which the European Commission has not yet been able to complete an equivalence decision by 21 December 2020. Even if equivalence decisions will be adopted for a number of other BCBS-IOSCO-compliant jurisdictions by then, the justification for having a derogation for cross-border intragroup transactions will continue to exist for many other jurisdictions. If the derogation is not extended, the impact on the ability of European derivative market participants to operate on a cross-border basis would be severe.

In order to address the risk of market fragmentation and instability resulting from termination of the temporary derogation in the absence of equivalence decisions, we would ask the European Commission and the ESAs to take steps urgently to extend the temporary derogation beyond 21 December 2020 (as currently proposed in the draft Margin RTS published in December 2019), until 21 December 2023, in order to ensure that EU firms have certainty regarding their continued ability to rely on this derogation and in order to ensure a level playing field between EU firms whose group is entirely within the EU and EU firms which operate on a global level and so have affiliates in multiple non-EU jurisdictions.

Such an extension would allow time for the European Commission to continue its work on assessment of the appropriateness of finding these jurisdictions equivalent. It would also allow other important jurisdictions more time to develop their regulatory frameworks with respect to OTC derivative business – in particular non-cleared margin rules – such that they are more aligned with EU and BCBS-IOSCO standards. Such an extension of the derogation would also maintain the competitiveness of EU supervised entities engaged in derivatives business with and in these third countries.

If the Intragroup derogation is not extended further under the Margin RTS, the ESAs should consult separately (and as soon as possible) on the expiry of the Intragroup derogation

If the European Commission and ESAs do not amend the draft revised Margin RTS to extend the derogation as respectfully requested, we urge the ESAs to (as soon as possible) conduct a full public consultation addressing whether or not the cross-border intragroup derogation should be extended. We believe that the ESAs should also, at that point (and certainly no later than 30 June 2020), make a statement to the effect that national competent authorities should not prioritise their supervisory actions, and should encourage them to further apply their risk-based supervisory powers in day-to-day enforcement of these requirements in a proportionate manner towards group entities that have benefited from the derogation until after this consultation has run its course and sufficient time has passed to either to effect any legislative changes deemed appropriate, or to give market participants time to put in place necessary infrastructure and documentation to apply this requirement should the consultation conclude that it is appropriate for the derogation not to be extended.

We believe that such a statement would be necessary as it seems unlikely that the ESAs could – at this stage – hold a consultation and draw conclusions from that consultation early enough to give market participants adequate time to comply with the requirement to apply margin requirements between group entities in different jurisdictions by 21 December 2020. Compliance with this requirement would be complex and costly (consider the requirement to establish segregated accounts for initial margin in dozens of non-EU jurisdictions, for example).

We believe it would be unusual for such an impactful requirement to be applied to market participants without any formal consultation having been held as to its appropriateness. We observe that the ESAs have not consulted on the derogation at any point since the adoption of the Margin RTS in 2016.

If the EU applies initial and variation margin to cross-border intragroup transactions it will be an outlier in comparison with other major jurisdictions

Currently the only margin rules that require exchange of IM in relation to transactions between affiliates are the margin rules of the US prudential regulators, who – following a consultation - are considering whether the IM requirement should be removed. A final rule is expected in a matter of weeks. The margin rules of the US CFTC and SEC, Brazil, Canada, Hong Kong, Japan, Singapore and South Korea do not require any exchange of margin between affiliates, and the Australian margin rules only require exchange of VM between affiliates in limited circumstances. In this regard, we would ask the European Commission to consider – for the purpose of future revision EMIR Level 1 - whether it continues to be appropriate for EMIR to require exchange of margin between affiliates.

We thank you for your consideration of this letter, and would be happy to discuss this issue further at your convenience.

Yours sincerely,

Scott O'Malia
CEO,
ISDA

James Kemp,
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Herve Guider,
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Wim Mijs,
CEO,
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Jakob Legård Jakobsen
Executive Director,
Danish Securities Dealers Association,
(current Presidency of NSA)

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 73 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org.

About EACB

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4,050 locally operating banks and 58,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 210 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 79 million members and 749,000 employees and have a total average market share of about 20%. Website: www.eacb.coop

About EBF

The European Banking Federation is the voice of the European banking sector, uniting **32 national banking associations** in Europe that together represent some **3,500 banks** – large and small, wholesale and retail, local and international – employing about **two million people**. **Website: www.ebf.eu**

About GFXD

The GFXD was formed in co-operation with the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA) and the Asia Securities Industry and Financial Markets Association (ASIFMA). Its members comprise 25 global foreign exchange market participants, collectively representing a significant portion of the FX inter-dealer market. Both the GFXD and its members are committed to ensuring a robust, open and fair FX marketplace and welcome the opportunity for continued dialogue with global regulators. Learn more about the GFXD at: www.gfma.org/foreign-exchange/

About NSA

The Nordic Securities Association (NSA) is a Nordic cooperation that works to promote a sound securities market primarily in the Nordic region. The NSA is formed by the Danish Securities Dealers Association (Børsmæglerforeningen), Finance Finland (Finanssiala), the Norwegian Securities Dealers

Association (Verdipapirforetakenes Forbund) and the Swedish Securities Dealers Association (Svenska Fondhandlareföreningen). Website: www.nsa-securities.com/