MARCH 2023

AFG - KEY MESSAGES ABOUT EMIR REVIEW

The AFG federates the asset management industry for 60 years, serving investors and the economy. It is the collective voice of its members, the asset management companies, whether they are entrepreneurs or subsidiaries of banking or insurance groups, French or foreigners. In France, the asset management industry comprises 680 management companies, with €4600 billion under management and 85,000 jobs, including 26,000 jobs in management companies.

The AFG commits to the growth of the asset management industry, brings out solutions that benefit all players in its ecosystem and makes the industry shine and develop in France, Europe and beyond, in the interests of all. The AFG is fully invested to the future.

AFG – KEY MESSAGES ON EMIR REVIEW

We highly welcome the Commission's EMIR 3.0 package proposal which aims to enhance the well-functioning of the central clearing framework and to reduce excessive exposure to substantially systemic clearing services of third country CCPs. We particularly appreciate the improvement of the CCPs regulatory framework on margin transparency which by the way should not only call on clearing members but also oblige CCPs to contribute and the clarifications on transaction exemptions. We fully support as well ESMA's approach of distinguishing cleared and uncleared derivatives products rather than between OTCDs and ETDs.

We are fully committed to support efficient and proportionate measures strengthening EU Capital Markets autonomy and safeguard financial stability. With this in mind, we are nevertheless concerned by the current design of active accounts under the proposal as long as sufficient information on its effective implementation is not available. We are particularly concerned with the risks of unintended negative consequences it could bear for EU Capital Market participants and investors for several reasons that will be developed in more detail hereafter.

CALCULATION OF CLEARING THRESHOLDS

Recital 7 + article 4(a)

We welcome ESMA's approach of distinguishing cleared and uncleared derivatives products rather than distinction between OTCDs and ETDs meaning that only derivatives not cleared by an authorized or recognized CCP are taken into account in the calculation of clearing thresholds. This approach is reflected in the new wording of Article 4(a) and is consistent with the removal of UK ETD derivatives from the calculation of clearing thresholds.

We furthermore advocate for a consistent and sustainable calculation method due to the risk profile of OTCDs and ETDs
Since the Brexit and the non-recognition of the UK regulated markets, we have had to treat UK ETDs differently depending on their Trade Date: those executed before 01/01/21 were considered as ETDs and those executed post-Brexit as OTCDs. The status of UK ETDs will depend on a renewal of equivalence of UK CCPs.

In order to be consistent with the clearing obligation under EMIR which aims at mitigating the systemic risk of high volumes of OTC derivatives from FCs and NFCs, we naturally need to exclude UK ETDs on a permanent basis as the risks associated with ETDs are almost non-existent due to their place of execution (regulated markets).

The current proposal leaves unaddressed an important element of uncertainty as to whether UK tier-2 CCP equivalence will be extended again after 30 June 2025. Accordingly, market participants request

either permanent recognition of UK CCPs or systematic recognition beyond June 2025, reflecting also the fact that the UK has retained and transposed into national regulation UK EMIR and UK EMIR REFIT.

ACTIVE ACCOUNT:

Article 7(a) + recital 9

Reminder of objectives

We understand and support the CMU action plan and more specifically the overall objective of the Commission to build a strong EU clearing system with robust clearing capacity, reducing systemic risks, and supporting EU financial stability.

In this context we remain convinced that any legislative measure requiring our industry to maintain directly or indirectly active accounts at an EU CCP for funds and portfolios subject to EMIR clearing obligation should be carefully built in order not to become counterproductive to the overall objective. We agree that this requirement may be considered as one option to avoid full relocation of corresponding contracts in continental Europe. However, it is quite difficult to have clear view at this stage on what this measure would mean exactly as no information is available at this stage on how such active accounts would have to be deployed and what would be their concrete functioning.

Main points for attention are listed below, the cases where implementation of these active accounts may be quite difficult.

Best execution obligation

Asset managers must act in the interest of their clients and are subject to the best execution obligation in investment matters.

This leads to a free choice of CCP, considering client preference, best-execution requirements, liquidity depth of the product/currency traded, margins and operational efficiency of the CCP. Any proposal to impose the choice of an EU CCP calls into question these principles.

Active Account perimeter

Our main concern is related to the consequences of active accounts where the requirement is combined with a prescribed minimum level of activity.

Any not well calibrated proposal imposing mandatory allocation of minimum level of activity at an EU CCP can bring obstacles to these principles.

In-scope products

3 categories of derivative products are identified to be cleared at least in part on a European CCP:

- IRDs in EUROS and in Polish Zloty,

- CDS in EUROS,

- STIRs in Euros,

We understand that In-scope products should only be those that are subject to mandatory clearing. In this respect, we question whether the 3 identified instruments are truly reflective of the clearing volumes found on substantially systemic tier-2 CCPs given that:

- In the CDS segment, there will be no Tier 2 substantially systemic CCPs (as ICE Clear Europe is closing down CDS clearing by Oct 2023).

- The reference to Short Term Interest Rate Derivatives (STIR) appears to reference futures and options. These aren't subject to the EMIR clearing obligation and should remain out-of-scope for the proposal (as above).

In all cases, we urge the commission to take into account the market developments which could affect the scope of the services identified as being of substantial systemic importance, providing that there are EU CCPs offering sufficient clearing services for the in-scope products.

We understand that apart from these 3 products, the other products can be cleared on a recognized CCP of our choice. Is our understanding correct?

Cost and operational constraints

We are concerned about the operational and cost constraints associated with the currency-based portfolio split induced by this proposal regarding the Active Account. Asset managers will be forced to split their portfolio to transfer part of their transactions in products enumerated in the proposal to a European CCP, with no guarantee of obtaining the same liquidity conditions and with a more limited choice of currencies, less efficient management (loss of the benefit of cross netting of products), operational constraints (maintaining different accounts at different CCP) and of course additional operating costs. This concern also applies to block trades.

Here are some specific scenarios where active accounts are expected to become costly and cumbersome to implement:

(a) Implementing an operational infrastructure pre- and post- trade capable to ensure allocation of proportion of trades to an EU CCP with ongoing monitoring

of thresholds to be respected will be complex and costly. One should have in mind that those costs will occur independently from the fact if there is one or hundreds of funds and accounts concerned.

(b) For multi-managed accounts having different asset managers for which all activity must be aggregated at client level to measure against defined ESMA proportion level and then allocate sub-proportions to different accounts and asset managers.

Apart from infrastructure costs additional costs will also incur for investors due to loss of netting benefit and an obligation to split trading activity by directing a proportion to an EU CCP. We expect considerable negative consequences from the fact that European buy side actors holding similar portfolios and employ similar hedging strategies will find themselves in a market which cannot offer balanced flows as providers offering opposite direction are not present.

(c) Maintenance of dual liquidity pools.

In-scope entities

We advocate to adapt the proposal to avoid that FCs and NFC+ which exclusively clear on EU CCPs would be captured by the obligation to calculate their positions with "authorized" CCPs (EU CCPs). In such case, active account requirement will not apply.

We consider that FCs and NFCs+ using only EU CCPs are deemed to be compliant with the regulation and are exempted from calculating their cleared positions and consequently exempt from reporting the result of their positions.

Our concern comes from the wording of Article 7 a) itself, the calculation and reporting obligation generally concerns FCs and NFCs *"that are subject to the clearing obligation ..... and shall clear at least a portion of such accounts at authorized CCP under".* While the calculation and reporting obligation should target FCs and NFCs that, in addition to having an active account at an EU CCP, also use recognized CCPs.

To illustrate our point, here is a proposed wording for the Article 7 a)-1:

«Financial counterparties or non-financial counterparties that are subject to the clearing obligation in accordance with Articles 4a and 10 and clear any of the categories of the derivative contracts referred to in paragraph 2 shall clear at least a proportion of such contracts at accounts at CCPs authorized under Article 14. Entities that clear exclusively on CCPs authorized under Article 14 are exempted from requirements under this article. "

Voluntary clearing by SFCs or NFCs which are not under the clearing obligation and/or voluntary clearing by any category of counterparties under EMIR (meaning in or out of scope of clearing obligation) of instruments which are not mandatory for clearing should not be captured by the active account obligation. Articles 7a, and 7b could be usefully amended to discard any ambiguity.

Calibration

The proposal states that the minimum level of activity and the functioning of the active account will be calibrated by ESMA in level 2 measures, to reduce exposure to tier-2 CCP.

In this regard ESMA's view on the necessary level to downgrade tier-2 CCPs from substantially systemic, would be helpful to any further analysis. There is no view at this stage on what would be the level of this threshold: will this be 5% of, 10% or 50%, of the in-scope products?

As earlier stated we are sceptical in regards to active accounts with an attached minimum activity level requirement.

Instead **an alternative proposal** could be envisaged, consisting in operating accounts as mandatory but without prescribed minimum thresholds. To our opinion those mandatory accounts will naturally incentivize the voluntary redirection of clearing activity to EU-CCP by actors for risk diversification purposes or for portfolios having only EUR exposures and by such making EU clearing over time more and more important. Also, those accounts being fully operational could absorb activity from non-EU CCPs in case of real threat to financial stability or any other form of stress on a third country CCP. In all cases, we agree with and strongly support the ESRB's position that a prior cost/benefit analysis would be of great value for the assessment of the feasibility and the determination of an efficient design of such accounts.

In addition, it is crucial that all participants in the clearing value chain are associated in the work that will be launched by ESMA for making proposals on the functioning and calibration of these active accounts. Any unfeasible and/or disproportionate measure could have unintended consequences and can jeopardize the EMIR framework as initially designed.

Legacy trades

We also think a calibrated proposal should provide for the introduction of a grandfathering principle for existing trades, which have already been executed and submitted for clearing through a non-EU CCP. Without such a mechanism, there would either be ambiguity as to the treatment of such trades (thereby leading to varied market practice as to their treatment) or, in the worst-case scenario, such trades would need to be closed out on one CCP and re-executed and cleared through a European CCP – which would

be a costly, time-consuming and in many cases commercially and operationally unworkable requirement.

Competitivity

The current clearing offer of EU CCPs does unfortunately not match the offer of their third country competitors and does not meet in the same way the industry's needs. Improving the clearing offer in the EU and not only regarding EU denominated products is the key to increasing clearing volumes and attractiveness of EU Clearing globally.

In other words, we believe that the active account proposal as set under the EC EMIR 3.0 proposal can result in disadvantaging EU asset managers, their clearing members and finally end-investors by generating additional complexity and cost.

We fear that it can make existing global investors to leave EU capital markets rather than to attract them. This can have negative effects on liquidity, contribute to fragmentation and finally be not able to efficiently eliminate any potential financial stability risk where the measure is not capable to impose same rules for all actors trading targeted products globally.

The alternative solution for mandatory accounts without prescribed minimum thresholds as mentioned above would present the big advantage of not harming the current Competitiveness of EU-based players as well as EU-based financial products, while the current proposal from the EC providing for minimum thresholds would definitely harm our competitiveness in comparison to non-EU based players/ non-EU based financial products. As an example, the solution currently envisaged by the EC would set a clear disadvantage for EU-based funds (being either EU UCITS or EU AIFs) vs. non-EU based funds, which could keep the freedom of clearing euro-denominated contracts where they want, at the best conditions.

In any case market participants will need early clarity on the extension of the equivalence decision for UK CCPs beyond June 2025 as effective implementation of such active accounts will require longer time than 2 or 3 years. This means that this new extension should already be envisaged.

REPORTING

Article 7(b) + Recital 10,11,14

Reporting obligation on the extent of clearing activity on CCPs recognized under Art. 25, specifying: (a) type of financial instruments or non-financial contracts cleared; (b) average values cleared over 1 year per EU currency and per asset class; (c) collected margins amount; (d) contributions to the default fund (e) largest payment obligation.

This extensive reporting obligation will result in significant additional costs and burden for the industry. Should this additional reporting be required, it should consider any existing reporting we already perform under EMIR (especially the new RTS on reporting).

Whether this reporting concerns the buy-side is a matter for clarification. We consider that this new reporting is only addressed to Clearing Members and their Clients who provide clearing services (which is generally not the case for Asset Managers), for the following reasons:

- This new reporting is inserted in a new para "Information on clearing services". This paragraph concerns clearing service providers.
- The purpose of this new reporting is to allow competent authorities to measure clearing activities with recognized CCPs. This explains the request for aggregated data, and only clearing service providers can provide data on their clearing activity and this in an aggregated manner. (Extract from Article 7b: *"shall report to their competent authority the scope of their clearing activity")*
- Some data cannot be provided by the Buy-side because they are the responsibility of the Clearing Members (e.g., Default Fund Contributions).
- Proposal for clarification: specify that these are clients that provide clearing services (as specified in Article 7 b) para 1). Article 7 b) *"Clearing members and clients* ***that provide clearing services*** *that are established in the Union... and that clear in a CCP recognized .... shall report..."*

EXEMPTIONS

Margining exemption for Single stock & equity index options

We ask for single stock & equity index options to be permanently (and no longer temporarily) exempted from the margin obligation. This position is in line with the exclusion already enjoyed by these products in many third country jurisdictions and with the joint trade association letter signed the 1st March 2023 requesting the permanent exemption from the margin requirements for single stock equity options and index equity options.

This is important given that the international context remains the same with exemptions from variation and initial margin exchange for these contracts continuing to prevail. Key financial centers either do not bring these instruments into scope of margining requirements (US and Singapore).

Exemption of these instruments does not create additional risk in the financial system given that they account for a very small proportion of the overall OTC market, and the fact that they are predominantly used for hedging and risk mitigation purposes. Given this, it makes little sense to burden market

participants in Europe with additional funding costs and operational complexity when trying to access these instruments.

A recital can be introduced in EMIR 3 that recognizes that in some major jurisdictions single-stock equity options and index options are not subject to equivalent margin requirements and that to avoid market fragmentation and to ensure a global level playing field it is appropriate to permanently exempt these contracts from the margin requirements.

Clearing thresholds/exclusion of FX derivatives contracts and hedging transactions

We support the exclusion of FX derivatives contracts (physically settled FX forwards and swaps) and hedging transactions from the calculation of clearing thresholds by mirroring the rationale for their exclusion to that of VM trading requirements. These are generally short-term, non-systemic transactions.

Intra-group transactions

A flexible exemption regime for intra-group transactions involving non-EU state for clearing thresholds should be made permanent: the exemption should not be conditional on an article 13 EMIR equivalence decision, nor should it depend on successive extensions of the temporary extension regime. Articles 3&4 resulting from the proposal should be amended accordingly.

However, we are not aware of the list of countries that would require equivalence for the use of an intra-group exemption with a third country counterparty which will be defined by the European Commission in a future delegated act. It is therefore difficult for us to take a position.

COLLATERAL

Eligible Collateral

We would like to expand the list of eligible collateral for Initial Margin to include money market funds (including third country funds). Similarly, EU domiciled MMFs should also be allowed as eligible investments by CCPs.

AFG believes that EU domiciled MMFs have key features that could qualify them as eligible instruments. They are highly regulated, well-diversified, short-term vehicles that invest in short term money markets (they are also presumed as eligible cash equivalent vehicles for their investors). MMFs also represent the safest products in the asset management space. They are highly liquid and stable investment vehicles in normal markets. Their liquidity depends on the underlying money markets own liquidity, as they are not guaranteed products, but investment funds that pass market opportunities and risks onto their investors. As mentioned in the report, most MMF regulations are under review for possible amendments to existing rules, because of the March 2020 turmoil. Though we strongly believe that the

liquidity issues that some non-public invested MMFs had then to address stemmed from money market malfunctioning, it is a fact that the reforming process initiated by both International and local authorities may justify a delay when assessing MMFs' inclusion in CCPs' investment universe.

In addition, and prior to any decision on this matter, AFG believes that further interactions with CCPs is important to better understand their needs and liquidity cyclicity, the way they diversify their liquidity sources and how they could implement a complementary investment source in MMFs and with which criteria (concentration ratio, investment cycles, divestment procedures, etc). Their proportional use of different sources of liquidity is important to understand to avoid risk concentration and ultimately forced selling concentrated on one sector or another in times of crisis. In addition, it is worth mentioning that Europe does not benefit from a unified government short term bonds market and there is no € denominated public debt MMF market, as reflected in the long-lasting limited level of PDCNAV MMFs' AUM.

The possible inclusion of MMFs should take into account the specificities of the European money markets and MMFs, the availability and link between different instruments that can offer CCPs an enhanced diversification of their liquidity sources.

Variation Margin (VM) for cleared and non-cleared derivatives

We would like the confirmation of the 4-month transition period for the implementation of VM documentation from eligibility (when an NFC is upgraded to NFC+ or FC status) as it is currently only mentioned in the paragraph 8 of the explanatory memorandum.

Moreover, we consider that securities (and not cash only) should be allowed as collateral for Variation Margin at EU CCPs to support their competitiveness. Indeed, government securities from EU member states are particularly liquid and could meet the intraday call constraints at CCPs

Initial Margin (IM) for cleared and non-cleared derivatives

We think the reform is a useful opportunity for Co-legislators to enhance some other areas of EMIR and ask for:

- the removal of FX forwards and swaps physically settled from the AANA calculation since they are exempted from posting IM/VM

- the alignment of the criteria for the NFC+ IM obligation (including the thresholds) with those applying for the NFC+ clearing obligation: we favor a "product per product" approach:

- the IM requirement to apply only on the category of derivatives for which the threshold is breached and avoid having the requirement to post/collect IM for all categories of derivatives.

- Alleviate back-testing requirements on the SIMM model that should no longer be required once the model is validated. We request the deletion of Article 14-3 of RTS 2066/2251 for phase 5 and 6 counterparties.

AFG

Ensemble, s'investir pour demain

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