ČESKÁ BANKOVNÍ ASOCIACE

Set up in 1990, the Czech Banking Association (CBA) is the voice of the Czech banking sector. The CBA represents the interests of 37 banks operating in the Czech Republic: large and small, wholesale and retail institutions. The CBA is committed to supporting quality regulation and supervision and consequently the stability of the banking sector. It advocates free and fair competition and supports the banks' efforts to increase their efficiency and competitiveness.

We appreciate the opportunity to comment on EBA, ESMA and EIOPA Consultation Paper **DRAFT REGULATORY TECHNICAL STANDARDS ON RISK-MITIGATION TECHNIQUES FOR OTC-DERIVATIVE CONTRACTS NOT CLEARED BY A CCP UNDER ARTICLE 11(15) OF REGULATION (EU) NO 648/2012**.

1. In general, we strongly oppose the requirement for a universal two-way exchange of initial margin between financial counterparties ("FC") and important non-financial counterparties ("NFC+"). We believe that the effects of the proposed rules are likely to lead to a significant liquidity drain on the market and the proposed initial margin requirements would have significant pro-cyclical effects in times of stressed financial markets.

2. In general, we also believe that intragroup transactions should be exempted from the margin requirements. The reasons for such exemption are similar to those for exclusion of intragroup transactions from clearing obligation (e.g. Recital 38 of Regulation (EU) No 648/2012 ("EMIR") sets out that "it is recognised that intragroup transactions may be necessary for aggregating risks within a group structure and that intragroup risks are therefore specific").

   Articles 11(5) - 11(10) of EMIR already specify certain conditions under which margin requirements are excluded in connection with intragroup transactions. We strongly suggest that the Commission delegated regulation sets out a general exemption for intragroup transactions, namely exclusion of exchange of initial margin. We believe that such exemption will be in line with the principle of appropriateness and proportionality. This general exemption should be set out in the Commission delegated regulation and intragroup transactions should be exempted from exchange of initial margin by virtue of the delegated regulation.

3. **Article 1 DEF(1)(i):** The definition of netting agreement is incorrect. The definition refers only to events of default, however, the market practice is such that the close-out netting mechanism applies not only in case of "events of default", but also in case of "termination events" (e.g. under ISDA Master Agreement).

4. **Article 1 GEN(3)(a):** It is unclear why netting of initial margin amounts between each other is prohibited. We propose deleting this limitation and allow margin amounts netting not only at transaction level, but also at portfolio level.

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5. **Article 2 GEN(3):** According to this provision, the respective threshold should be monitored at group level; however the exchange of initial margin is based on bilateral agreements. This may cause complexities in the documentation and procedures. We suggest considering that the threshold will be monitored at bilateral level, rather than at group level. In addition, we believe that the thresholds for initial margin exchange should be negotiated and mutually agreed by the parties at bilateral level, rather than specified by the law. We also suppose that in case of regulated entities the thresholds for initial margin exchange should be set in relation to Tier 1 capital.

6. **Article 2 GEN(4):** We do not see any reason why these rules should apply only between financial counterparties and non-financial counterparties. We believe that these rules should apply also between financial counterparties (similarly to those set out in Article 2 GEN (3)).

7. **Article 2 GEN(4)(b):** According to Article 11(3) of Regulation (EU) No 648/2012 ("EMIR") the requirements to have "risk-management procedures that require the timely, accurate and appropriately segregated exchange of collateral with respect to OTC derivative contracts" (i.e. the margin requirements) are applicable only to NFC+ after the clearing threshold is exceeded by them. Non-financial counterparties other than those referred to in Article 10 of EMIR ("NFC") are exempted from these rules under EMIR. Therefore it is unclear why Article 2 GEN(4)(b) requires that the exclusion of collateral exchange in connection with transactions entered into with NFC must be agreed between the parties. This provision would lead to renegotiation of all contracts with NFCs to exclude the margin requirements. Such renegotiation will be just another administrative burden imposed on market participants without any reason. Article 2 GEN(4)(b) is in conflict with Article 11(3) of EMIR, which stipulates that the margin requirements are applicable only to NFCs+. It means that the exclusion of margin requirements regarding NFCs is automatic and it does not require an agreement between the parties as it is presumed by Article 2 GEN(4)(b). Therefore Article 2 GEN(4)(b) should be deleted in its entirety and the Commission delegated regulation should explicitly set out that the margin requirements are not applicable to OTC derivatives contracts with NFCs.

8. **Article 2 GEN(4)(c):** EMIR is not applicable to entities referred to in Article 1(4) and (5) of EMIR. It means that also the margin requirements under the Commission delegated regulation are not applicable to transactions with these entities. Article 2 GEN(4)(c) is in conflict with Article 1(4) and (5) of EMIR, if it requires that the margin requirements must be excluded by agreements with these entities. The margin requirements regarding these entities are excluded automatically and the Commission delegated regulation may not require that this must be excluded by agreements between the parties. Therefore Article 2 GEN(4)(c) should be deleted in its entirety and the delegated regulation should explicitly set out that the margin requirements are not

applicable to OTC derivatives contracts with entities referred to in Article 1(4) and (5) of EMIR.

9. **Article 2 GEN(4)(d):** We believe that the margin requirements should be automatically excluded in case of centrally cleared derivatives transactions, including indirectly cleared transactions and no additional agreements between the parties may be required in this regard. Therefore Article 2 GEN(4)(d) should be deleted in its entirety and the delegated regulation should explicitly set out that the margin requirements thereunder are not applicable to indirectly cleared OTC derivatives contracts.

10. The Commission delegated regulation should explicitly set out that the margin requirements are applicable only to new contracts concluded upon entry into force of the delegated regulation. Since the variation margin is usually calculated at portfolio level, it is unclear, how should apply the new margin requirements regarding variation margin at portfolio level in connection with transactions concluded prior to entry into force of the delegated regulation. Also certain aspects of initial margin (e.g. Article 1 EIM(4)) are calculated at portfolio level and it is unclear how should apply the new margin requirements regarding initial margin at the portfolio level in connection to the transactions concluded prior to entry into force of the delegated regulation.

11. **Question 3:** We are of the opinion that the requirements regarding cover pools are sufficient and they should not be further tightened.

12. **Article 1 VM(1):** We are of the opinion that the minimum frequency of variation margin collection should be one week, rather than one day. The daily collection represents too strict operational burden for smaller financial counterparties. In addition, we believe that the delegated regulation should not specify explicit frequency for variation margin collection. It should rather set out a general rule that the variation margin is collected with "sufficient frequency".
    The delegated regulation should also clarify that the variation margin is calculated at portfolio level.

13. **Article 1 EIM(4)(c):** This provision is unclear, please clarify.

14. **Article 1 EIM(4)(f):** Period of 10 days is too short. This should be prolonged at least to 30 days. In addition, we believe that the delegated regulation should not specify explicit frequency for the total amount of initial margins recalculation and collection. It should rather set out a general rule that the total amount of initial margins is recalculated and collected with "sufficient frequency".

15. **Article 6 MRM(1)(a):** The validation of initial margin model should be allowed to be performed by internal risk management units or internal audit units of the parties. The

requirement to validate the model by an independent party is unjustified and unreasonable.

16. **Article 6 MRM(2):** The legal enforceability of netting agreements within the EU should be ensured by the adoption of the long-discussed draft Netting Directive.

17. **Article 6 MRM(3):** It is unclear what is meant by “knowledgeable third-party”.

18. **Article 2 LEC(1)(a):** We are of the opinion that the minimum frequency of collateral re-evaluation should be at least one week, rather than one day. The daily re-evaluation represents too strict operational burden for smaller financial counterparties. In addition, we believe that the delegated regulation should not specify explicit frequency for collateral re-evaluation. It should rather set out a general rule that the collateral is re-evaluated with “sufficient frequency”.

19. **Article 6 LEC:** We believe that eligible collateral, as well as appropriate haircuts for the collateral used, should be determined by the parties involved, rather than by the regulation.

20. **Article 6 LEC(1)(c):** It is unclear what is meant by “otherwise subject to significant wrong way risk”.

21. **Article 7 LEC:** We are of the opinion that implementation of concentration limits for collateral is not justified and it is senseless. The idea of concentration limits is based on the expectation that default of counterparty may decrease the value of collateral (posted in the form of securities issued by a third party). However, this may happen only in extraordinary market circumstances, when the defaulting counterparty is a global systematically important bank (such as Lehman Brothers was). Only in such case may the collapse of one counterparty lead to depreciation of the collateral. Therefore, the implementation of concentration limits may by justifiable (if at all) only in case of counterparties which collapse may depreciate certain types of collateral. Defaults of a financial counterparty or non-financial counterparty usually do not lead to the collapse of markets and to the depreciation of collateral. The implementation of concentration limits is not justifiable in general.

22. **Article 1 SEG:** Segregation and third party custody should not be required by regulation and re-hypothecation should not be prohibited by regulation. A party collecting initial margin should offer segregation as an option so the parties can agree on segregation if commercially appropriate. In addition, it is unclear how should the segregation requirements apply in case of cash collateral, when the collecting entity is a bank. Does this requirement mean that such cash will not belong to the assets of the bank?

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23. **Article 1 SEG(5):** We are of the opinion that the EU should implement the laws (directives, or regulations) which will ensure that the segregation arrangements regarding initial margin are legally enforceable. It is a strange situation when the lawmaker requires from the addressees of the law that they are obliged to ensure the legal enforceability of requirements set by the lawmaker. Such obligation may be imposed in connection with jurisdictions outside the EU, but in connection with jurisdictions within the EU this should be ensured by the law (i.e. the EU law should ensure that the segregation arrangements regarding initial margin are legally enforceable within the EU; similarly like the Directive on Financial Collateral Arrangements ensures today that the financial collateral arrangements are legally enforceable throughout the EU). Until such laws are adopted within the EU it is not justifiable to impose this requirement on the market participants.

24. **Article 1 FP(3):** We do not agree with the requirement that the gradual implementation of initial margin requirements must be agreed between the parties. This will lead to renegotiation of all agreements and this will impose just another reasonless administrative burden on the market participants. The gradual implementation of initial margin requirements should be automatic by virtue of law, without necessity of specific agreements.
    The implementation of the initial margin requirements is gradual between 2015 and 2019, but in 2019 a disproportionate jump is presumed (the threshold is reduced from EUR 0.75 trillion to EUR 8 billion). Therefore we are of the opinion that the process of introduction of initial margin requirements should be prolonged to be more proportionate.

25. **Article 1 FP(6):** We are of the opinion that the margin requirements should apply to a specific contract only when and until all thresholds for such requirements are met, but not throughout the life of the contract, if the contract be subject to the requirements when entered.

We hope that our response to EBA, ESMA and EIOPA consultation paper is sufficiently clear and our views are helpful for preparing the regulatory technical standards.

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