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

Natixis is the international corporate, investment management and financial services arm of Groupe BPCE, the second-largest banking player in France.

Natixis leverages the highly technical skills and responsiveness of its teams to furnish clients tailor-made solutions on the fixed-income, forex, commodities, credit and equity markets and responds to their hedging, financing and investment needs.

Natixis provides liquidity on:
•swaps and other plain vanilla derivatives on the short and long terms
•derivatives for hedging bond issues
•asset swaps
•hedging or liability optimisation programs via a broad range of complex interest-rate products

We are also highly active on the inflation asset class, both on cash bonds and bespoke derivative solutions (vanilla or hybrid).

General Comments

Natixis is fully supportive of the approach followed by the ESAs to develop margining requirements under EMIR based on the final BCBS-IOSCO policy framework.

We appreciate the rationale for introducing risk mitigation techniques for OTC derivatives that are not cleared by a CCP and the benefits from the expected reduction to systemic risk.

We would like to take the opportunity of this Consultation Paper to stress the importance of the OTC derivatives in general, and bespoke and customised transactions in particular, for our end user clients both within the European Union and in other jurisdictions.

Central clearing offerings are far from being stabilised and despite our strong commitment and interest in the development of new clearing offerings by CCPs, some products that are fundamental in our clients' hedging and financing strategies still do not benefit from suitable clearing infrastructures.
The scope of products subject to the risk mitigation techniques and the timing of the entry into force of the obligations should therefore be appropriately balanced so as to avoid undesired effects such as discouraging the use of OTC derivatives to hedge risks.
Furthermore, despite the phase-in period proposed in the Final Provision of the draft RTS, we are very concerned that the implementation of the obligations in less than 18 month' time will be extremely

challenging and could cause operational risks. Indeed, many aspects of the draft RTS mandate bilateral agreements with our clients in order to opt out some of the requirements. This process is both time consuming and complex because of the lack of a public register of the Covered Entities (as defined in the BCBS-IOSCO policy framework) and because of the impacts on the existing legal framework of OTC derivatives. For example, upgrading the existing credit support annexes to meet the RTS requirements represents a massive effort with and depends on both parties' willingness to support the costs, as no standard industry solution to tackle this issue has been developped.

More generally, Natixis fully endorses the FBF's comments regarding the need for international consistency. We share the FBF's concerns regarding the need for harmonisation in the scope of both covered instruments and entities, and in the aproach to collateral re-use. All of these three aspects should be clearly set as high priority items in the discussions on international convergence in order to ensure a level playing field for all market participants.

Response to the Consultation Paper

Q1: What costs will the proposed collateral requirements create for small or medium-sized entities, particular types of counterparties and particular jurisdictions?

Is it possible to quantify these costs?

How could the costs be reduced without compromising the objective of sound risk management and keeping the proposal aligned with international standards?

We anticipate that the collateral requirements will create significant operational and financial costs for all market participants, especially for our smaller clients who have no or limited experience in this field.

Some of the covered entities may have very limited flexibility in the type of collateral available for posting and could face serious liquidity issues because of this.

Building an adequate infrastructure and / or outsourcing the collateral management process to third parties will also prove costly for this type of Covered Entities (as defined in the BCBS-IOSCO policy framework).

Natixis is particularly concerned with the time and effort that will be required to obtain the appropriate representations from third country based clients who are clearly out of the scope of the Covered Entities. Obtaining these representations from third country entities while EU domiciled clients benefit from the exemption when they are under the clearing threshold introduces a bias in the implementation of the risk mitigation techniques.
We strongly urge for a disapplication of the requirements for third country entities that would be considered Non-Financial Counterparties under the clearing threshold if they were established in the European Union. Outright exemption of these entities would not compromise the policy framework objectives that targets "financial firms and systemically important non-financial entities".

More generally, we endorse the FBF's comments on the extraterritorial issues that the industry will face when a client's regulatory regime is not or partially consistent with the European obligations.

Q2: Are there particular aspects, for instance of an operational nature, that are not addressed in an appropriate manner?

If yes, please provide the rationale for the concerns and potential solutions.

Art. 2 GEN and art. 1 FP of the draft RTS detail the risk management procedures in specific cases and list 8 instances where agreements in writing or other equivalent methods are required to benefit from these specific arrangements. From an operational point of view, obtaining these arrangements within the time frame defined in the RTS will cause significant bottlenecks and will prove extremely difficult to achieve in a satisfactory manner.
For the sake of efficiency and in order to limit operational risk during the implementation of the obligations, we recommend that the approach to the application of these specific conditions be reviewed in favour of an opt-out mechanism from the counterparties to the OTC transactions rather than the positive consent.

Art. 1 SEG of the draft RTS defines the initial margins segregation requirements and specifies that legal opinions on the segregation arrangements are required.
Due to the potentially high number of laws/jurisdictions involved in derivative transactions and custody relationships (e.g. law applicable to the counterparties to the transaction, the collateral collecting and receiving parties, the collateral issuer, the custodian, sub-custodians and depositary, law applicable to the contracts, etc., we anticipate that internal and external legal opinions will be both lengthy and costly to obtain and may be significantly qualified. We therefore question the frequency for re-issuing a legal opinion and would recommend that new legal opinions should be mandated as and when the relevant laws and regulations evolve rather than on a fixed periodic basis. Clarification is also needed on the conditions required for internal legal opinions from independent legal counsels to be valid and to what degree qualified opinions could be taken into consideration. Finally, we strongly recommend that legal opinions covering a specific set of jurisdictions instead of each individual client's situation should be taken into account to limit the strain on legal resources.

Art. 1 VM and art.1 EIM of the draft RTS specify that counterparties shall collect margins on the day following the execution of the contract. We believe that the wording of this requirement should be clarified both to take into account the prevailing market practice and settlement delays for cash and non-cash collateral and also to describe the margin computation step and the actual collateral transfer step of the process. The requirement should also take into consideration practical issues, such as when the counterparties are operating in different time zones or are subject to different banking calendars.

Art. 1 FP – 4 of the draft RTS details the phase-in period and the conditions for exempting certain contracts from the IM collection obligation.
We support the phased in approach and would like to point out that under its current wording, its effects might be too limited because of the way some existing risk mitigation techniques operate.
Indeed, bilateral and multilateral portfolio compression is now common practice and is mandated by the EMIR for counterparties with more than 500 outstanding contracts. The effect of these compression exercises is to terminate existing contracts and to enter into replacement contracts that represent the same risk profile but with considerably less outstanding gross notional. Similarly, for operational or organisational reasons, it is frequent to novate the rights and obligations of a contract from one counterparty within a group to another.
We are of the opinion that contracts entered into following novations of pre-existing contracts should also benefit from the phase-in exemptions, especially for these two categories mentioned above (ie results of compression runs and of novations between entities of a same group). Excluding these contracts from the phase in period could have the undesired effect for some counterparties to refrain from participating in compression runs or deliberately tightening the conditions for submitting contracts for compression.

Arts. 1-3 IGT of the draft RTS detail the procedures concerning intragroup derivatives contracts. We strongly support the proposal and would like to stress the fact that for operational reasons, some flexibility should be given in the way the exemptions are applied (ie exchanging collateral in some circumstances despite the fact that the exemptions have been granted).

Q3: Does the proposal adequately address the risks and concerns of counterparties to derivatives in cover pools or should the requirements be further tightened? Are the requirements, such as the use of the CRR instead of a UCITS definition of covered bonds, necessary ones to address the risks adequately?

Is the market-based solution as outlined in the cost-benefit analysis section, e.g. where a third party would post the collateral on behalf of the covered bond issuer/cover pool, an adequate and feasible alternative for covered bonds which do not meet the conditions mentioned in the proposed technical standards?

The proposal adequately addresses the risks and concerns of derivatives in cover pools and should not be tightened further.

Q4: In respect of the use of a counterparty IRB model, are the counterparties confident that they will be able to access sufficient information to ensure appropriate transparency and to allow them to demonstrate an adequate understanding to their supervisory authority?

We strongly support the RTS as currently drafted that allows for a model to be either developed by one of the two parties or jointly by the two parties, or to be provided by a third party agent.
We are confident that the adequate information will be available for all parties to justify understanding of the model to their supervisory authority.

Q5: How would the introduction of concentration limits impact the management of collateral (please provide if possible quantitative information)?

Are there arguments for exempting specific securities from concentration limits and how could negative effects be mitigated?

What are the pros and cons of exempting securities issued by the governments or central banks of the same jurisdiction?

Should proportionality requirements be introduced, if yes, how should these be calibrated to prevent liquidation issues under stressed market conditions?

Art. 7 LEC – 1 of the draft RTS details the concentration limits for collateral collected from an individual counterparty both for IM and VM.
Whilst we appreciate the rationale for introducing such concentration limits, we are concerned with the massive workload and associated operational risk that these limits would introduce.
We believe that concentration limits should kick in only above a fixed threshold in order to avoid applying the concentration rules to comparatively small amounts.
We also strongly urge for the introduction of a grace period for substituting the collateral in case of breach of a concentration limit.

Q6: How will market participants be able to ensure the fulfilment of all the conditions for the re-use of initial margins as required in the BCBS-IOSCO framework?

Can the respondents identify which companies in the EU would require re-use or re-hypothecation of collateral as an essential component of their business models?

We are of the opinion that the re-use of the initial margins should be consistent at the international level and that under no circumstances should the obligations under the RTS materially differ from other G20 jurisdictions' regulations.