

ECBC Response to the European Commission

Public Consultation on Regulation (EU) No 648/2012 on OTC Derivatives, Central Counterparties and Trade Repositories

Brussels, 12 August 2015

The European Covered Bond Council (ECBC)¹ represents the covered bond industry, bringing together covered bond issuers, analysts, investment bankers, rating agencies and a wide range of interested stakeholders. The ECBC was launched by the European Mortgage Federation (EMF) to promote the interests of covered bond market participants at international level. As of August 2015, the ECBC brings together over 100 members from more than 25 active covered bond jurisdictions representing over 95% of the EUR 2.6 trillion outstanding covered bonds.

The ECBC welcomes the opportunity to provide the European Commission with its feedback on the Public Consultation with regard to the European Markets Infrastructure Regulation (EMIR)² which was launched on 21 May 2015. The ECBC would also like to thank the European Commission for their ongoing commitment to a constructive dialogue.

General Comments

As a matter of background information, covered bonds are dual recourse debt instruments issued by credit institutions (the covered bond issuer) and secured by a cover pool of financial assets, typically composed of mortgage loans and/or public-sector debt. For over 200 years, covered bonds have proved to be an efficient debt instrument enabling banks to mobilise private sector means and capital towards long-term investment with a wide public benefit and, in particular, housing loans and public sector debt. They have also been, during the recent financial turmoil, one of the only asset classes able to restore investor confidence and to ensure access to debt capital markets for European issuers.

The ECBC is strongly supportive of the goal of improving the resilience, transparency and efficiency of the OTC derivatives market. It therefore welcomes the efforts of the European Institutions to take into account the specificities of covered bonds. In Recitals 16 and 24 of EMIR, European regulators have indeed considered that two specificities should be taken into consideration when establishing the draft technical implementation measures:

- The specific provisions of covered bonds' legal frameworks that would make OTC derivatives, which are used to hedge interest rate and/or currency risk within covered bond programmes (referred to herein as "covered bond derivatives"), ineligible for clearing through a Central Clearing Counterparty (due to, among other reasons, the fact that the derivative is designed to survive the insolvency of the issuing institution, whereas the standardised documentation requires that all derivatives be closed out at the time of an issuer's insolvency).
- The fact that in many jurisdictions collateral posting is unilateral (as dictated by covered bond legal frameworks and rating agency criteria) - i.e. the issuer does not post collateral, whereas the counterparty does, when required.

¹ The European Mortgage Federation - European Covered Bond Council (EMF-ECBC) is registered in the European Institutions' Transparency Register under ID Number 24967486965-09.

² Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, Counter Counterparties and Trade Repositories.

Specific Comments

Question 1.5: CCP Margins and Collateral

(b)(i) Is the spectrum of eligible collateral appropriate to strike the right balance between the liquidity needs of the CCP and its participants?

The use of covered bonds as collateral is possible under EMIR. However, the actual use of covered bonds for collateral purpose is limited by the fact that the central counterparties (CCPs) have not been very active in adding covered bonds to their collateral lists.

Covered bonds are secure and liquid instruments, some qualify as Level 1 assets under the Liquidity Coverage Requirement (LCR). Moreover, covered bonds play an important role in the financing of the real economy and support growth in the economy as envisaged by the European Commission's Capital Market Union initiative.

Taking into account this background, it could be suggested that the European Commission should encourage and support a more widespread use of covered bonds as collateral instruments, e.g. for margins at CCPs.

Question 2.1: Definitions and Scope

(i) Are there any provisions or definitions contained within Article 1 and 2 of EMIR that have created unintended consequences in terms of the scope of contracts or entities that are covered by the requirements?

(ii) If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?

Trades with a longer settlement period than the standard settlement period (up to 7 days) are defined as forwards under EMIR. Therefore, a standard trade with a longer than normal settlement period is covered by the requirements outlined in EMIR, e.g. margining, transaction confirmation, transaction valuation, portfolio reconciliation, etc.

However, central banks are exempt from the obligations under EMIR. This gives rise to challenges when market participants are subjected to EMIR trades with central banks. For instance, the market participants cannot get transaction confirmation, when the counterparty (i.e. the central bank) is not subject to rules outlined in the regulation. In some instances, this could result in making the market participant unable to comply with the requirements under EMIR.

There are examples of central banks that do provide the necessary LEI codes, trade confirmation, etc. which makes it possible for market participants to comply with EMIR.

Therefore, a possible suggestion could be to find a solution that facilitates trades between two parties where one party is subject to EMIR and the counterparty is not, so that the trades could be handled straight-through processing (STP) and in compliance with EMIR.

Question 2.3: Trade Reporting

(i) Are there any significant ongoing impediments or unintended consequences with respect to meeting trade reporting obligations in accordance with Article 9 of EMIR?

(ii) If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?

Indeed, there are some ongoing impediments or unintended consequences with regard to meeting trade reporting obligations as per Article 9 EMIR.

For instance, the setup and specification trade reporting has been finalised late in the process leaving a limited amount of time for the industry to implement. In the implementation phase, the specification has been changed adding extra cost and complexity to the industry. Guidance to understand the trade reporting regime and technical details on how to fill in different fields in the trade reports has often been accompanied by frequent changes and new additions to the Q&A document prepared by the European Securities and Markets Authority (ESMA). It is important to note that besides the initial cost in introducing a new reporting system, there is also the extra cost incurred by frequent changes to this system, even though each change might be initially considered as a minor one.

In addition, the abundance of fields and the possibility of variations within each field make the reconciliation process extremely difficult, especially without any clear guidelines for the process. A suitable example could be given with the fields concerning price/rate and price notation where only a combination of the two fields makes the reconciliation meaningful. In general, a smaller number of fields and a higher focus on the quality of the reconciliations process would provide much more useful information. The overall result is an extensive and complex reporting system, which is interpreted differently by the counterparties which could lead to producing unmatched reports from counterparties. From an industry perspective, the quality and usability of the received data is questionable. Therefore, reasonable care must be taken in order to establish a manageable and well-functioning reporting system.

In this relation, please also refer to our answer to Question 2.1 above.

Question 2.4: Risk Mitigation Techniques

(i) Are there any significant ongoing impediments or unintended consequences with respect to meeting risk mitigation obligations in accordance with Articles 11(1) and (2) of EMIR?

(ii) If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?

In this relation, please refer to our answer to Question 2.1 above.

Question 2.7: Transparency

(i) Have any significant ongoing impediments arisen to ensuring that national competent authorities, international regulators and the public have the envisaged access to data reported to trade repositories?

(ii) If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?

In this relation, please refer to our answer to Question 2.3 above.

Question 2.10: Additional Stakeholder Feedback

(i) Are there any significant ongoing impediments or unintended consequences with respect to any requirements or provisions under EMIR and not referenced in the preceding questions that have arisen during implementation?

(ii) If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?

Based on the feedback received from our members, some expressed the concern that the potential market impact of both EMIR and the subsequent regulatory technical standards was not assessed thoroughly enough before their adoption, which could ultimately result in extra costs for the financial sector. Considering this, it could be argued that the implementation and the outcome of EMIR would have been more successful, if more resources had been dedicated to designing a model to be implemented in practice prior to launching the regulatory process.

Therefore, while acknowledging that the EMIR requirements serve a purpose, it is also important to consider the impact they will have on the industry. As for all business types, costs incurred are covered by the revenue, meaning that customers ultimately pay more for their purchases. For instance, in the case of mortgage lending, the additional cost will affect the price of the loan for prospective borrowers, which may in turn reduce economic growth. With this in mind, the right balance between prudential regulation and economic growth should be sought to ensure that growth potential is not sacrificed in favour of more regulation and reporting.

Concluding Comments

The ECBC stands ready to assist the European Commission in its role of market catalyst and think-tank. We very much hope that you will take our remarks into consideration. Please, do not hesitate to contact us, if we can be of any assistance or if you would like further clarification or elaboration on our views.