

EMIR : Clearing obligation for small financial counterparties

BSA Response to ESMA CP

1 September 2016

Introduction

The Building Societies Association (BSA) welcomes the consultation by ESMA, and is pleased to respond on behalf of our members. The BSA represents all 44 UK building societies. Building societies have total assets of over £345 billion and, together with their subsidiaries, hold residential mortgages of over £270 billion, 21% of the total outstanding in the UK. They hold over £250 billion of retail deposits, accounting for 18% of all such deposits in the UK. They employ approximately 40,000 full and part-time staff and operate through approximately 1,550 branches.

The BSA belongs to the European Association of Cooperative Banks and supports the EACB's collective response.

Access to clearing for small FCs

ESMA has correctly summarised the key difficulties in relation to the clearing obligation. The position stated in paragraphs 11 to 15 exactly reflects the experience of our medium sized and smaller members. But we also draw ESMA's attention to wider problems affecting small FCs. Our small members are beginning to report difficulty in finding swap providers prepared to deal with them (whether on cleared or uncleared basis), or being quoted two prices, a favourable one based on CCP clearing, and an adverse one based on traditional bilateral settlement. We suspect that the clearing obligation is, in isolation, only one – though probably the most important – part of a series of measures which are together having the unintended consequence of reducing small FCs' access to derivatives altogether. ESMA's current proposal, though welcome, cannot deal with the wider problem. We would encourage ESMA to carry out a wider study into this area.

Question 1

While categorisation can be a dynamic matter, currently almost all of our 44 building society members fall into Category 3 for both contexts. Their volume of activity in interest rate swaps is modest but appreciable (but well below the Category 3 thresholds) while their volume of activity in CDS is believed to be negligible.

Question 2

Neither the BSA nor any of our members can offer clearing services

Question 3

Our largest 5 to 10 members, who may lie towards the upper end of the Category 3 range, have typically established (or are in the process of establishing) clearing arrangements for interest rate swaps with one or more clearing members. A negotiating group of 15-20 of our medium and smaller members, together with 5-10 small UK banks, are currently working towards establishing a lower-cost collective clearing arrangement with a clearing member, but this is not fully in place yet.

Activity of FCs in the relevant OTC derivative classes

We agree with ESMA's observations in section 3. Figure 2 and Table 1 are especially instructive – they confirm, as the BSA and EACB have previously argued – that the largest counterparties already account for the vast majority of derivative trades, and that – even in aggregate – the

trades of small FCs are simply not significant in relation to the stated objectives of EMIR. The most telling single figure is that fewer than the 500 largest counterparties account for 99.4% of IRS activity.

Current level of FCs' CCP clearing experience

We strongly support the conclusion in paragraph 41, based on interpretation of the Figure 3 and Figure 4 data, that an extension of the phase-in period for smaller FCS cannot compromise the primary objective. It is clear that the most active high volume counterparties already have access to clearing, since they have already reported cleared trades – in the case of IRS this covers periods even before clearing became mandatory for large FCs. The fact that the IRS clearing obligation is now in force for Category 1 firms, and will be in force for Category 2 firms by December 2016, means that the vast majority of actual IRS trades will be being cleared through CCPs by the beginning of 2017, regardless of what is decided for Category 3.

Question 4

We have some anecdotal information to support the above view. Especially since around the time that the clearing obligation took effect for Category 1 firms in June 2016, IRS providers have become reluctant to deal with small FCs that are not themselves ready for CCP clearing, and/or quote two prices for swaps, a more favourable one based on CCP clearing, and a more adverse one based on traditional non-cleared bilateral settlement. We take this as an indicator that by the middle of 2016 a very significant migration of the bulk of IRS trades into CCP clearing is taking place, well in advance even of the Category 2 deadline.

Proposal to modify the phase-in period for Category 3

We support the reasoning in paragraphs 50 to 67, and the conclusions in paragraphs 68 to 70.

Question 5

We agree that the present category definitions be retained, and the application date for Category 3 be postponed.

Question 6

We support the addition of a further two years to the deadline for Category 3.

Question 7

We are content with ESMA's approach, but our members are not impacted by the other item.

Cost benefit analysis

We agree that Option 1 is preferred on CBA grounds, as it avoids re-classification and also uncertainty for other counterparties pending publication of the final TS.

Conclusion

We welcome and support ESMA's proposals, but draw attention to wider concerns about small FCs' access to derivatives overall.

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The Building Societies Association (BSA) is the voice of the UK's building societies.

We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the government and parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of over £330 billion, and account for approximately 20% of both the UK mortgage and savings markets