Banking & Payments Federation Ireland

BPFI Response to Central Bank of Ireland

Consultation Paper 90

Consultation on the Supervision of

Non-Financial Counterparties under EMIR

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Introduction

Banking & Payments Federation Ireland (BPFI) is the voice of banking and payments in Ireland. Representing over 70 domestic and international members institutions, we mobilise the sector's collective resources and insights to deliver value and benefit to members, enabling them to build competitive sustainable businesses which support customers, the economy and society.

We welcome the Central Bank of Ireland's stated position in regard to their new responsibilities of supervising compliance with EMIR in the most efficient and effective way. We also note that this consultation paper only addresses the supervision of EMIR compliance for NFCs and the challenges this raises and the fact that these NFCs are likely to be unknown to the CBI. We also note that the CBI has stated that their supervision does not encompass every aspect of a NFC's business, but is limited to its derivative activity.

We also welcome the Central Bank's stated position that they wish to be thorough without being excessively intrusive and that they wish to develop a supervisory framework which is both fit for purpose and cost effective.

1. Do you think that this is the optimal categorisation which the Central Bank should use to underpin our supervisory framework? If not what other categorisation would you propose?

We note the thresholds of NFCs which hold more than €3bn in gross notional value in OTC interest rate derivatives for the purposes of speculation or more that €1bn gross notional value in OTC equity derivatives which do not have a hedging purpose are considered to be NFC+ and this is this population of customers that CBI are focused on identifying and ensuring they fulfil all their additional requirements under EMIR.

Customers that do not breach these limits still have EMIR requirements and CBI needs to be able to evidence that they are both fulfilling these obligations and that they are genuinely below these limits.

Therefore it is our opinion that there should be only 2 categories of NFC, namely 'NFC+' (with additional EMIR requirements and who breach the thresholds for non-hedging related derivatives and 'NFC' that do not breach the thresholds for non-hedging related derivatives).

Counterparties can qualify as a NFC (i.e. not an NFC+) in 2 ways: Holding under €3bn interest rate derivatives, or €1bn equity derivatives, which are undertaken for speculative purposes, or by satisfying one of the 4 tests detailed below (regardless of volume)

Covering risks arising from the potential change in the value of assets, services, inputs, products, commodities or liabilities that the NFC or its group owns, produces, manufactures, processes, provides, etc. in the normal course of business.

Covering risks arising from the potential indirect impact on the value of assets, services, inputs, products, liabilities, or commodities, (as set out above) resulting from the fluctuation of interest rates, inflation rates, foreign exchange rates, or credit risk.

A NFC must be satisfied that an OTC derivative contract qualifies as a hedging contract under the International Financial Reporting Standards adopted in accordance with Article 3 of Regulation (EC) 1606/2002.

In the event that the NFC holds non hedging related derivatives, these do not breach the thresholds of €3bn in gross notional value in OTC interest rate derivatives or €1bn gross notional value in OTC equity derivatives

We understand the CBI requires assurance that larger NFCs are only transacting derivatives for bona fide hedging purposes. Consideration should be given to accepting attestation from the Board of Directors together with appropriate clause in their Memorandum and Articles of Association that these derivatives are used for bona fide hedging of identified business risks and are in no way speculative.

We would encourage the CBI to be mindful of the approach the FCA is adopting as a large number of larger NFC counterparties (not NFC+) have company structures where they can have parts of their company set up in each jurisdiction and can deal derivatives in either jurisdiction. In the event that the CBI introduces additional requirements that are more onerous or expensive this will encourage customers to trade under FCA's EMIR framework.

If CBI wants to introduce a further category of smaller NFC (i.e. below €100m in outstanding trades) with a view to further simplifying their requirements, this is worth exploring.

Summary

Customers <€100m – attestation together with thematic risk based CBI reviews

Customers >€100m – Board of Directors attestation together with M&A clause re hedging

Customers > €100m that will not provide attestation or M&A hedging clause – full ERR

2. Should the minimum threshold be set at a level above the criteria specified in the S.I. and if so, what would be the appropriate level?

The counterparty having outstanding OTC derivative contracts which cumulatively have a gross notional value of greater than €100m during the reporting period would seem appropriate but this will require a level of self certification as some customers may be multi banked. Having a limit of 100 outstanding contracts would appear to serve little purpose as there could be instances of a counterparty with a high volume of forward FX contracts

(greater than 100) with relatively low value that could trigger them into a category not intended.

3. **Do you envisage any operational or other difficulties with the Central Bank adopting this approach?**

If so please provide commentary as to how these difficulties could be resolved?

We would encourage the CBI to be mindful of the approach taken in other jurisdictions. Every effort should be made to ensure that NFCs across jurisdictions face the same regulatory and compliance hurdles.

4. **Should the Central Bank accommodate tailored submission periods from NFCs, or should it determine a fixed date for the submission of all ERRs?**

The alignment of the submission of the ERR to the annual accounts preparation of the NFCs would appear to be a reasonable approach.

6. **If you are of the view that the ERR should be adopted, as broadly outlined, are we asking the right questions in the ERR? If there are questions which can be improved upon, please let us have this feedback.**

As detailed in the reply to Q1 – we believe the ERR form should only be completed by customers that are NFC+ counterparties or NFCs that have open positions in excess of €100m that will not provide attestation or M&A hedging clause.

We believe the level of detail is broadly relevant for this category of customer.

8. **What is your view on the proposed role of a Third Party Assessor?**

Our members have considered whether banks might fulfil the role of a Third Party Assessor and have identified a number of issues and constraints with this approach including:

a) As noted above, we expect that the majority of banks medium-sized NFC clients would enter into derivatives with multiple bank counterparties. Acting as Third Party Assessor in respect of these clients' EMIR Regulatory Returns ("ERRs") would require banks to obtain and reconcile potentially confidential and commercially sensitive information on derivatives trading of these clients with other competitor bank counterparties.
b) Completing the required analysis as a Third Party Assessor may also highlight differences in interpretations and reporting treatments applied by banks in respect of trade reporting requirements and identify reporting errors or omissions in competitor banks' trade reporting solutions.
c) It is likely that IT systems development would be required in order to make the provision of a Third Party Assessor service feasible. Our members would expect that such IT development would be complex given the potential varying data formats from the trade repositories and also the multiple bank counterparties. The information technology investment and development required is likely to be significant and would be competing with other significant demands for IT investment including ESMA Level 2 Data Validations and MIFID II regulatory change programme.
d) We note that the Central Bank of Ireland have clarified that, if properly structured, there should not be a priori conflict in the same institution providing reporting services and being the Third Party Assessor. Some of our members do not currently have the required structure expertise or capacity within a function which might have sufficient detachment to fulfil the role of a Third Party Assessor.
e) As a new service not previously provided by our members, and with the likely associated organisational and IT changes required to support the provision of a Third Party Assessor service, some of our members expect that the cost of providing such a service might not be competitive when compared with other potential service providers such as professional service and accountancy firms.

f) Our members would view the provision of Third Party Assessor services to be akin to a professional service and the provision of this type of service is not currently consistent with member bank's strategy.
g) The potential legal implications of providing Third Party Assessor services would require further due diligence, including but not limited to, applicability of professional indemnity insurance and compliance with ISO 4400.

In consideration of the associated constraints outlined above, our members do not believe that banks are best placed to act as Third Party Assessors, and given the potential confidentiality and commercial sensitivities, we would expect that NFC clients would not seek their counterparty banks to provide such a service.