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WORKING DOCUMENT

From:	Presidency
To:	Working Party on Financial Services and the Banking Union (EMIR/CCP) Financial Services Attachés
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Subject:	EMIR Review: working party 11.07.23 - Presidency non-paper on post-trade risk reduction services (PTRRS)



NON-PAPER ON THE TREATMENT OF POST-TRADE RISK REDUCTION SERVICES (PTRRS)

Background

“Post Trade Risk Reduction Services (PTRRS)” is not a defined term in EU legislation, but they can be seen as **non-price forming transactions which aim at reducing risks** such as counterparty, credit and operational risk, without changing the market risk of the portfolios. The main offerings of PTRRS have historically been portfolio compression services, but new services have been developed to help manage operational and counterparty risk in the OTC market through the introduction or the cancellation of transactions following strategies of rebalancing or optimisation of different variables linked to the risk management of the exposures such as initial margin requirements, counterparty risk, etc.

In its November 2020 report to the Commission on post trade risk reduction services with regards to the clearing obligation (EMIR Article 85(3a)), **ESMA concluded that a limited and qualified exemption of PTRRS from the clearing obligation would further reduce not only risk in the market, but also its overall complexity:**

“ESMA concludes that the benefits of allowing certain PTRR transactions to be exempted from the clearing obligation would reduce risk in the market, allow for legacy trades to be compressed, increase participation in PTRR services of counterparties less interested to participate today (due to complex structures) and overall reduce complexity in the market by using simpler trades for rebalancing. ESMA is of the view that, in the absence of compelling evidence or reasoning to the contrary, those positive effects outweigh, inter alia, the increased operational burden on market participants and regulators and the increase in gross risk in the non-cleared netting sets (in case of portfolio rebalancing).”

At the same time, the report highlighted that the market for **PTRRS** is highly concentrated with only three main providers, and that the use of these services is **becoming of systemic importance**. In the context of that work, the ESRB noted that PTRR service providers should

be subject to proportionate regulatory requirements to ensure that they act independently and according to established rules and parameters which have been reviewed by a competent authority, in particular to avoid any use that aims to circumvent the clearing obligation. ESMA therefore recommended in that report that, in order to benefit from any exemption from the clearing obligations, PTRRS and their providers should be subject to certain conditions.

Despite these recommendations, the **Commission has not included an exemption** from the clearing obligation from PTRRS in the EMIR review proposal. During its **public consultation**, the Commission identified **split views on the issue of PTRRS**:

“Views differed regarding the effects of post-trade-risk-reduction. While banks and trade associations thought that multilateral compression is effective in reducing risks (also in the uncleared space), financial market infrastructures highlighted that post-trade-risk-reduction at CCPs already takes place and may well reduce certain risks. However, they stressed that it is important to note that compression does not reduce the risk exposure but only results in a reduction of the notional exposure held. Moreover, several respondents pointed to the importance of network effects as post-trade-risk-reduction measures are more effective in large CCPs.”

PTRRS were discussed in Council Working Party 3 April based on a **non-paper submitted by the CZ delegation** (WK 4263 2023 INIT).

The Swedish Presidency also asked Member States whether they considered it appropriate to include within this EMIR review an exemption from the clearing obligations for transactions formed from PTRRS and, if such an exemption were to be introduced, whether safeguards should be included to prevent such activity from being used to avoid compliance with clearing obligations. The Presidency believes, in light of the oral feedback and written comments received, that Member States are open to such an exemption being included in EMIR. In order to identify a compromise position, the **Presidency is seeking views from Member States regarding the most appropriate treatment of PTRRS**.

The **draft report** submitted on 13 June to the ECON committee by the EP’s **rapporteur MEP Danuta Hübner contains amendments to introduce an exemption** for PTRRS.

Q1: Do you prefer:

- a) Detailed safeguards to be set out in **Level 1**? If yes, which additional safeguards would you consider necessary?
- b) A **mandate for ESMA for an RTS** specifying certain conditions in relation to the exemption of PTRRS from the clearing obligation?

Q2: Do you consider **supervisory arrangements** in view of the **systemic importance of PTRRS providers** necessary? If yes, which supervisory arrangements would you consider appropriate:

a) Only regulate the service provided (for example with requirements on how to provide the service)? Do you think ESMA may have any role in monitoring PTRRS where transactions that could be exempted from that clearing obligations are agreed, irrespective of whether the service provider is subject to supervision by a NCA?

b) In addition to a), require such providers to be authorised under MiFID or any other regulation? If the latter, which one? Do you believe that, where appropriate, basic regulatory standards should be adopted for the provision of PTRRS?

Q3: Do you consider that the use of a PTRRS by any entity subject to the clearing obligation requires any kind of approval or non-objection process by its NCA prior to its use or do you consider that the control that the clearing obligations are not evaded should be done, in any case, in an ex post supervisory process?

Member States will be invited to submit **written comments on the draft legal text** in relation to an exemption of PTRRS from the clearing obligation.

Possible drafting on Article 4ba

Post-trade Risk Reduction Services

1. Without prejudice to risk-mitigation techniques under Article 11, Article 4(1) shall not apply to OTC derivative contracts that are formed and established as the result of a post-trade risk reduction services ('PTRR transactions') exercise where agreed by the parties to the transactions.
2. PTRR transactions may only be exempted from the clearing obligation pursuant to the first subparagraph where the PTRR service provider and each participant to the PTRR comply with the requirements set out under paragraph 3 and 4 of this Article, respectively.
3. A PTRR exercise shall:
 - a) be performed by an entity independent of the counterparties to the OTC derivative contracts included in the exercise;
 - b) be market risk neutral;
 - c) not contribute to price formation;
 - d) take the form of a compression, rebalancing or optimisation;
 - e) be executed on a bilateral or multilateral basis ;
 - f) achieve a reduction in the counterparty credit risk in each of the portfolios submitted to the exercise;
 - g) be accepted or rejected in full and, as a result, the participants to the exercise shall not be able to choose which trades to execute under the exercise;

- h) be open for participation only to the entities initially submitting a portfolio to the exercise.

4. A PTRR service provider shall:

- a) be authorised in accordance with Directive 2014/65/EU;
- b) carry out PTRR exercises under pre-agreed rules, methods and algorithms in pre-scheduled cycles and in a reasonable, transparent and non-discriminatory manner;
- c) ensure that entities participating in a PTRR exercise have no influence over the result of the exercise;
- d) in order to prevent a build-up of transactions in portfolios, undertake a compression exercise after each PTRR exercise resulting in new transactions;
- e) keep records of the transactions executed pursuant to a PTRR exercise, including information on transaction entered into the exercise, transactions resulting from the exercise either as modified transactions or as new transactions, and the overall change in the risk of the different portfolios included in the exercise;

The competent authority which has authorised the PTRR service provider shall notify ESMA about the authorisation [and submit an assessment of how the conditions set forth in paragraphs 3 and 4 are met. ESMA shall transmit this assessment to the authorities of each Member State with supervisory powers in relation to the clearing obligations set forth in Article 4 of this Regulation.]. [Where a PTRR service provider no longer complies with the requirements set out in this paragraph, the competent authority [may withdraw its validation for the exemption for new PTRR transactions][shall inform ESMA]].

The competent authority that has authorised a PTRR service provider shall, on a yearly basis, confirm that the provider complies with the requirements set out in this Article. The competent authority shall also communicate the list of the entities offering PTRR services it authorised, and any updates thereto, to ESMA, which shall publish that list.

5. ESMA shall develop draft regulatory technical standards to further specify the conditions set out in paragraphs 3 and 4, including aspects such as market neutrality in the PTRR exercise, requirements of the management of the PTRR exercise, requirements for different types of PTRR services and how to monitor the correct application of the exemption granted, ensuring the clearing obligation is not circumvented. ESMA shall submit those draft regulatory technical standards to the Commission by [12 months after entry force of this amending Regulation].

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph of this paragraph in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010.