



European Securities and  
Markets Authority

# Consultation Paper

**Report on post trade risk reduction services with regards to the clearing obligation (EMIR Article 85(3a))**



## Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **15 June 2020**.

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading 'Your input - Consultations'.

### Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

### Data protection

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading '[Data protection](#)'.

### Who should read this paper?

All interested stakeholders are invited to respond to this consultation paper. In particular, responses are sought from financial and non-financial counterparties of OTC derivatives transactions, entities providing post trade risk reduction services as well as from central counterparties (CCPs).

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# 1 Executive Summary

## Reasons for publication

ESMA is mandated to provide a report to the European Commission (EC), in cooperation with the ESRB, on whether any trades that directly result from post-trade risk reduction services (PTRR services), including portfolio compression, should be exempted from the clearing obligation referred to in Article 4(1) of EMIR. As input for this report, ESMA is looking into the different types of PTRR services being offered, their purpose and whether there is a need for the new trades that these may generate to be exempted from the clearing obligation, and if such an exemption could lead to the risk of some counterparties circumventing the clearing obligation.

## Contents

Section 2 provides an introduction to this consultation paper. Section 3 covers the types of post trade risk reduction services, including what they are, how they function, the risks they aim to reduce and why market participants use them. Section 4 asks for respondents to provide data on the use of PTRR services today. Section 5 assesses how the current clearing obligation affect those services and the need to clear or to exempt the new trades that might be generated by PTRR services (PTRR transactions) from the clearing obligation. Section 6 assesses the risks with an exemption from the clearing obligation. Section 7 considers how PTRR services are regulated globally. Section 8 considers some conditions or restrictions that may apply if an exemption to the clearing obligation would be provided and if PTRR service providers should be regulated.

## Next Steps

ESMA will consider the feedback it receives from this consultation in Q2 2020 and expects to publish a final report to the European Commission in mid-2020.

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## 2 Introduction

1. On 20 May 2019, the European Parliament and the Council adopted Regulation (EU) 2019/834, EMIR Refit, amending Regulation (EU) 648/2012, EMIR, as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk mitigation techniques for OTC derivatives contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories. EMIR Refit was published in the Official Journal on 28 May 2019<sup>1</sup>.
2. Under Article 85(3a) of EMIR<sup>2</sup>, ESMA shall provide, by 15 May 2020<sup>3</sup>, a report to the Commission, in cooperation with the ESRB, on whether trades that directly result from post-trade risk reduction services, including portfolio compression (PTRR services) should be exempted from the clearing obligation referred to in Article 4(1) of EMIR. For ESMA to provide its determination, ESMA shall investigate PTRR services, explain the purpose and functioning of PTRR services and the need for the trades directly resulting from PTRR services to be exempted from the clearing obligation and, if exempted, whether this could lead to a circumvention of the clearing obligation.
3. Following the report from ESMA, EMIR further requires the EC, by 18 December 2020, to prepare a report assessing whether any trades that directly result from PTRR services, should be exempted from the clearing obligation referred to in Article 4(1) of EMIR. The EC shall submit the report to the European Parliament and to the Council, together with any appropriate proposals<sup>4</sup>.
4. Extract from Article 85(3a) of EMIR (as amended by EMIR REFIT).

3a. By 18 May 2020, ESMA shall submit a report to the Commission. That report shall assess: [...]

(d) in cooperation with the ESRB, whether any trades that directly result from post-trade risk reduction services, including portfolio compression, should be exempted from the clearing obligation referred to in Article 4(1); that report shall:

(i) investigate portfolio compression and other available non-price forming post-trade risk reduction services which reduce non-market risks in derivatives portfolios without changing the market risk of the portfolios, such as rebalancing transactions;

(ii) explain the purposes and functioning of such post-trade risk reduction services, the extent to which they mitigate risk, in particular counterparty credit risk and operational risk, and assess the need to clear such trades or to exempt them from clearing, in order to manage systemic risk; and

(iii) assess to what extent any exemption from the clearing obligation for such services discourages central clearing and may lead to counterparties circumventing the clearing obligation;

5. PTRR services aim at reducing risks such as counterparty, credit, operational and systemic risks, without changing the market risk of the portfolios. The main offerings of

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<sup>1</sup>OJ L 141, 28.5.2019, p.42. The text can be found following this link: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0834&from=EN>

<sup>2</sup> EMIR 648/2012 as amended including by EMIR Refit.

<sup>3</sup> However, due to the difficult circumstances in which ESMA is publishing this consultation as a consequence of the COVID-19 pandemic, a longer consultation period has been considered that will impact the preparation of the report to be sent to the Commission.

<sup>4</sup> Article 85(3) of EMIR.

PTRR services have historically been portfolio compression services but new services have been developed and the two main PTRR services today are portfolio compression and PTRR services using risk offsetting transactions such as rebalancing/optimisation services<sup>5</sup>.

6. The main objective of the consultation paper is to consider whether a special regime, in the form of an exemption to the clearing obligation for transactions directly resulting from the use of PTRR services, should be included under EMIR.
7. MiFIR<sup>6</sup> specifically excludes transactions that derive from portfolio compression from best execution requirements and from the derivatives trading obligation. The consultation paper notes the interlinkage with MiFIR and poses questions to gather relevant information, however the paper does not assess possible effects of linking an exemption to the clearing obligation with the exemption to the trading obligation.
8. This consultation paper does not elaborate on a possible exemption from the margin requirements for PTRR transactions as this aspect is not within the mandate provided to ESMA. This also means that where this paper considers the benefits and risks of an exemption from the clearing obligation for certain trades generated from PTRR services, it does not affect the application of the risk mitigation techniques requirements under Article 11 of EMIR, in particular that bilateral margining would apply to OTC derivatives not cleared by a CCP (provided that the counterparties and contracts are in scope of the relevant requirements).
9. It is finally noted that by assessing possible conditions and/or restrictions in the consultation paper this should not be interpreted as a suggestion that an exemption to the clearing obligation for compression and/or other PTRR services such as rebalancing is proposed. However, given the objective of this consultation paper, to report on PTRR services, it is important to also consider conditions and/or restrictions at this stage.

### 3 Post Trade Risk Reduction Services

10. The broader term of PTRR services refers to both portfolio compression services as well as to other types of PTRR services. One of the main offerings of risk reduction services is multilateral portfolio compression but also rebalancing and other types of risk mitigating techniques are currently used in the market.
11. The term *portfolio compression* is used in EMIR Level 2 in relation to the risk mitigation techniques for OTC derivative contracts not cleared by a CCP and is a defined term in MiFIR<sup>7</sup>. PTRR services is not a defined term under EMIR or MiFID/MiFIR but is referred

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<sup>5</sup> Rebalancing/optimisation is used in this paper to refer to risk mitigation techniques using offsetting trades to achieve its risk reduction.

<sup>6</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02014R0600-20160701>

<sup>7</sup> Article 2(47) of MiFIR “‘portfolio compression’ means a risk reduction service in which two or more counterparties wholly or partially terminate some or all of the derivatives submitted by those counterparties for inclusion in the portfolio compression and replace the terminated derivatives with another derivative whose combined notional value is less than the combined notional value of the terminated derivatives.”

to in Recital 27 of MiFIR<sup>8</sup>. Although this is not a definition and it is inserted in a recital rather than in an enacting term, this seems to indicate that transactions resulting from PTRR services could be seen as non-price forming transactions which reduce non-market risks in derivatives portfolios without changing the market risk of the portfolios.

12. Portfolio compression helps reducing risks such as counterparty, operational and ultimately systemic risks, by reducing the number of trades and/or notional exposure between counterparties. In its report “Risk Mitigating Standards for Non-centrally Cleared Derivatives”, IOSCO described the outcome of compression as: “*diminished operational risk for individual market participants which may, in turn, lessen systemic risk and enhance overall financial market stability*”<sup>9</sup>. In other PTRR services, such as rebalancing, new transactions are entered into to reduce counterparty risk by reducing the exposure between two counterparties and this is viewed by market participants as a way to also reduce systemic risk by decreasing the overall exposure in the market between counterparties. To further reduce systemic risk, this may be done by involving a CCP (where possible) to reduce counterparty risk. Operational risk is also reduced by the reduction in exposure and by managing risk by improving the efficiency and transparency of portfolios. Having said this, operational risk may though increase if there is a build-up of exempted transactions over time in relation to, for example, rebalancing transactions.

**Question 1: Would you agree with the description of the benefits (i.e. reduced risks) derived from PTRR services? Are there any missing? Could PTRR services instead increase any of those risks? Are there any other risks you see involved in using PTRR services?**

### 3.1 Portfolio compression

13. Portfolio compression is a post-trade mechanism which aims to reduce the number of contracts and/or the notional amounts of derivatives contracts in a particular asset class/product without changing the market risk of the portfolios. Portfolio compression can be carried out bilaterally (between two parties in relation to their portfolio with each other) or multilaterally between multiple entities in relation to their portfolios with all of the other counterparties taking part in the compression.
14. CCPs may perform compression as, by interposing themselves between two counterparties, the CCP ends up with several transactions with different counterparties and may conduct netting or termination of exposures where only the net exposure would remain as the exposure towards the CCP within the given parameters. CCPs may also, depending on the scope of services, undertake multilateral compression using the services of PTRR service providers. Multilateral portfolio compression of uncleared

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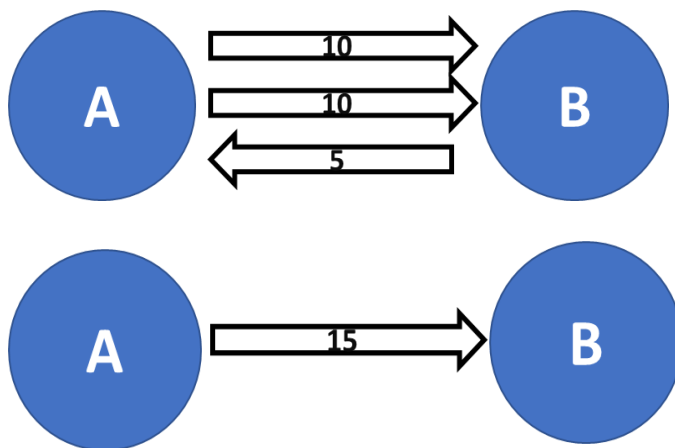
<sup>8</sup> Recital 27 of MiFIR: “The obligation to conclude transactions in derivatives pertaining to a class of derivatives that has been declared subject to the trading obligation on a regulated market, MTF, OTF or third country trading venue should not apply to the components of non-price forming post-trade risk reduction services which reduce non-market risks in derivatives portfolios including existing OTC derivatives portfolios in accordance with Regulation (EU) No 648/2012 without changing the market risk of the portfolios. In addition, while it is appropriate to make specific provision for portfolio compression, this Regulation is not intended to prevent the use of other post-trade risk reduction services.”

<sup>9</sup> <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD450.pdf>



transactions is a PTRR service similar to the multilateral compression undertaken by a CCP but without a central counterparty such as a CCP posing in the core of the compression.

15. Portfolio compression can involve terminating or amending existing transactions to reduce their notional amount or replacement trades terminating existing transactions and replacing those with a new transaction(s) that reflects the reduced notional amount. For the purpose of EMIR, those replacement/amended trades would be treated as new trades and therefore become subject to the clearing obligation if applicable.
16. Only trades with matching characteristics can be netted and terminated against each other, thereby somewhat limiting the potential effectiveness of compression. Therefore, in order to increase the efficiency of the compression exercise, the scope of transactions that could be compressed together would need to be extended by accepting nearly matching transactions in the compression. To achieve this, counterparties can provide instructions or tolerances for the compression exercise<sup>10</sup>, for example, allowing trades to be included with similar but not identical payment dates or different maturity dates e.g. allowing the DV01<sup>11</sup> of the portfolio against a certain interest rate to change up to x EUR/bp. Without the constraint of perfectly matching cashflows and payment dates for each participant, the multilateral compression exercise results in a significantly increased compression efficiency.
17. This picture shows a simple form of compression where a new replacement transaction replaces the three original transactions<sup>12</sup>.



**Question 2: Would you agree with this description of portfolio compression? Please explain the different compression services that are offered and how they may differ from**

<sup>10</sup> To note, Commission Delegated Regulation (EU) 2017/567 requires: "Before each compression process is initiated, investment firms and market operators providing portfolio compression shall: (a) require each participant to the portfolio compression to *specify the participant's risk tolerance* including specifying a limit for counterparty risk, a limit for market risk and a cash payment tolerance."

<sup>11</sup> The DV01 of a position or portfolio indicates the amount by which its value will change if the underlying interest rate changes by 1 basis point.

<sup>12</sup> Other examples may be found in ISDA's paper on PTRR services: <https://www.isda.org/a/TDmEE/EMIR-REFIT-Incentivizing-Post-Trade-Risk-Reduction-Whitepaper.pdf>

the description above. Are there today viable alternatives to using PTRR services to achieve a similar outcome?

**Question 3: Without changing the market risk of the portfolios, how different can the transactions included in the portfolio compression exercise be? Would the market risk be changed at all by the applied tolerances and if yes, how can the portfolio remain market neutral? What tolerance levels are often applied and could/should restrictions be placed on tolerances?**

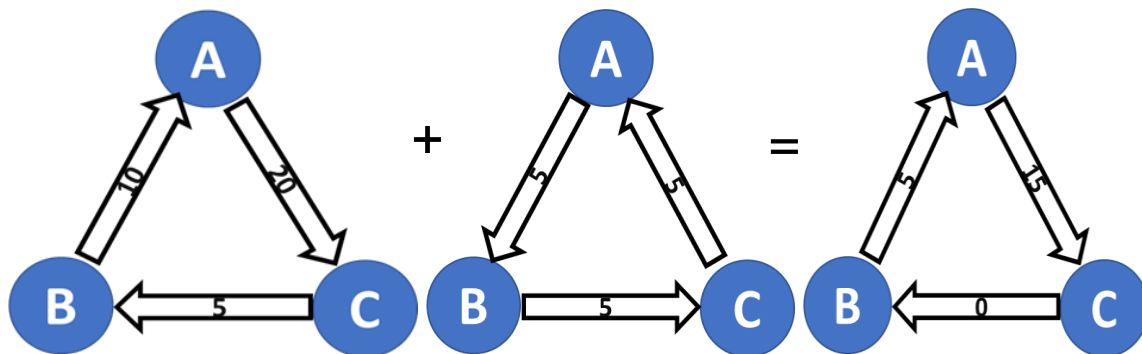
**Question 4: Should there be a clearing exemption for PTRR trades that are a direct result from a portfolio compression? If not, why? Is there a difference between bilateral and multilateral portfolio compression for the sake of an exemption?**

### **3.2 PTRR services using offsetting transactions**

18. Where the PTRR service provider offers other types of services than compression, i.e. offsetting transactions to reduce risk in the portfolio, rebalancing and/or risk optimisation services are the main PTRR services applied but there are probably other established PTRR services either structured similarly or differently providing reduced risk in designated portfolios. Rebalancing/optimisation are today offered across bilateral and cleared counterparty risk. Rebalancing services are most often run on a multilateral basis where each participating firm provides the sensitivities<sup>13</sup> of their portfolio to the PTRR service provider. Below is an example (simplified) illustrating how multilateral risk mitigation using offsetting transactions (for example used in rebalancing and optimisation services) can be used.
19. (I) Risk between counterparties before rebalancing. A's net position is 10, B's net position is 5 and C's net position is minus 15. (II) All parties enter into new transactions of 5 with each other. The net exposure for each party is 0, i.e. A, B and C are all flat as they enter into two transactions netting out each other. (III) After the new off-setting transactions have been entered into as described above, each counterparty is left with the same net exposure as originally (i.e. A net position is 10, B net position is 5 and C net position is 15) but the bilateral exposure to each other counterparty is reduced (e.g. A had originally a 20 exposure to C which is now reduced to 15).

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<sup>13</sup> For example, a party has several bilateral portfolios with a few counterparties and sensitivity is often measured in relation to a change, i.e. the EUR 5yr swap rate increases by 1 basis point ("1bp"). The effect of 1bp change results in changes in Party X's exposure to a given counterparty and this would be referred to the portfolios sensitivity to change.



20. The non-linear nature of the risk offsetting transaction's payoff will probably require the counterparty to rebalance on a regular basis as the underlying asset or risk factor fluctuates over time, adding yet more new trades to the portfolio. Ultimately, this would potentially lead to a build-up of non-cleared vanilla trades. To mitigate this build-up of transactions, as it might add risk and complexity to the portfolio, these rebalancing transactions would need to be monitored and managed to ensure the transactions entered into would be subject to compression exercises on a regular basis. Today EMIR requires portfolio compression to be undertaken at least twice a year (please see below "EMIR and portfolio compression" for details).

**Question 5: Would you agree with this description of PTRR Services? What other forms of PTRR services exist? What do they do? How do they work? Are there any other viable alternatives to PTRR services, if yes, why are they not sufficient?**

**Question 6: Without changing the market risk of the portfolios, how different can the transactions included in the PTRR exercise be? What tolerance levels are often applied and what restrictions could/should restrictions be placed on tolerances (if applies)?**

**Question 7: Is the requirement under EMIR of portfolio compression sufficient to mitigate the risk of build-up of transactions and how is the market managing this risk today?**

**Question 8: Based on all of the above, how would you define (algorithm based, second order risk, market neutral) PTRR services that cover all of the relevant aspects?**

**Question 9: Should there be an exemption from the clearing obligation for PTRR trades (other than portfolio compression) that are a direct result from a PTRR exercise? If not, why?**

### 3.3 Potential offsetting cleared trades

21. Reducing the counterparty risk in PTRR transactions could be done in different ways, one way could be to enter into two additional exactly offsetting trades, one of which would remain bilateral and the other would be cleared in order to transfer to a CCP, through a cleared trade, counterparty risk. This construct would leave the overall net exposure of

the counterparty unchanged for each participant, but it would shift the net risk from the bilateral sub-portfolio to the CCP.

**Question 10: Is there a PTRR service today including offsetting transactions with a CCP?**

**Question 11: Assuming there would be an exemption to the clearing obligation:**

- (i) **Could PTRR services conduct offsetting opposite trades in the counterparty's cleared portfolio and if yes, should it be mandatory to enter into such offsetting transactions?**
- (ii) **Would the PTRR transaction in the non-cleared portfolio then remain between the counterparties or be terminated (netted)?**

### 3.4 EMIR and portfolio compression

- 22. EMIR in Article 11(1) requires that counterparties that enter into an OTC derivative contract not cleared by a CCP must have appropriate procedures and arrangements to measure, monitor and mitigate operational risk and counterparty credit risk.
- 23. Pursuant to EMIR regulatory technical standards<sup>14</sup>, financial counterparties and non-financial counterparties with 500 or more OTC derivative contracts outstanding with a counterparty which are not centrally cleared must have in place procedures to regularly, and at least twice a year, analyse the possibility to conduct a portfolio compression exercise in order to reduce their counterparty credit risk. If counterparties do not conduct portfolio compression, they should be able to provide a *reasonable and valid explanation* to the relevant competent authority for concluding that a portfolio compression exercise *is not appropriate*.
- 24. The scope of portfolio compression is subject to a Q&A<sup>15</sup> with the conclusion that portfolio compression does not prevent an offsetting transaction to be concluded with a counterparty different from the counterparty to the initial transaction. The Q&A further clarifies some justifications for not undertaking a portfolio compression.

#### EMIR Article 11(1)

1. Financial counterparties and non-financial counterparties that enter into an OTC derivative contract not cleared by a CCP, shall ensure, exercising due diligence, that appropriate procedures and arrangements are in place to measure, monitor and mitigate operational risk and counterparty credit risk, including at least:

- (a) the timely confirmation, where available, by electronic means, of the terms of the relevant OTC derivative contract;
- (b) formalised processes which are robust, resilient and auditable in order to reconcile portfolios, to manage the associated risk and to identify disputes between parties early and resolve the, and to monitor the value of outstanding contracts.

<sup>14</sup> Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP.

<sup>15</sup> [https://www.esma.europa.eu/sites/default/files/library/esma70-1861941480-52\\_qa\\_on\\_emir\\_implementation.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-1861941480-52_qa_on_emir_implementation.pdf)

**Delegated Regulation 149/2013**
**Recital**

*Portfolio compression may also be an efficient tool for risk mitigation purposes depending on circumstances such as the size of the portfolio with a counterparty, the maturity, purpose and degree of standardisation of OTC derivative contracts. Financial counterparties and non-financial counterparties that have a portfolio of OTC derivative contracts not cleared by a CCP above the level determined in this Regulation should have procedures in place in order to analyse the possibility to use portfolio compression that would allow them to reduce their counterparty credit risk.*

**Article 14 Portfolio compression**

Financial counterparties and non-financial counterparties with 500 or more OTC derivative contracts outstanding with a counterparty which are not centrally cleared shall have in place procedures to regularly, and at least twice a year, analyse the possibility to conduct a portfolio compression exercise in order to reduce their counterparty credit risk and engage in such a portfolio compression exercise.

Financial counterparties and non-financial counterparties shall ensure that they are able to provide a reasonable and valid explanation to the relevant competent authority for concluding that a portfolio compression exercise is not appropriate.

**OTC Question 10 [last update 4 June 2013]**

Article 14 of Regulation (EU) 149/2013: Portfolio Compression

- (a) When financial and non-financial counterparties conclude that a portfolio compression exercise is not appropriate, they need to be able to provide a "reasonable and valid explanation". What is considered as a "reasonable and valid explanation"?
- (b) Does the requirement on portfolio compression prevent an offsetting transaction to be concluded with a counterparty different from the counterparty to the initial transaction?

**OTC Answer 10**

- (a) The explanation the counterparty needs to be able to provide to the competent authority when they are requested to do so should adequately demonstrate that portfolio compression was not appropriate under the prevailing circumstances. Depending on the circumstances, the justification could include that:
1. the portfolio is purely directional and does not allow any offsetting transactions;
  2. multilateral compression services are not available in the relevant markets, for the relevant products, or to the relevant participants and that compression on a bilateral basis would not be feasible;
  3. compression would materially compromise effectiveness of the firm's internal risk management or accounting processes.
- (b) No. The requirement on portfolio compression does not prevent an offsetting transaction to be concluded with a counterparty different from the counterparty to the initial transaction.

### 3.4.1 The clearing obligation under EMIR

25. EMIR requires that all OTC derivative contracts subject to mandatory clearing (entered into or novated on or after the relevant clearing obligation start date) must be cleared in an authorised or recognised CCP. The clearing obligation covers standardized transactions that are considered suitable for clearing and whilst clearing has improved efficiency and reduced counterparty risk and thereby strengthened the stability of the market in line with the G20 commitments, clearing is not suitable for all types of trades. More complex transactions, such as exotic derivatives are not considered suitable for clearing and would instead be subject to specific risk mitigation requirements, such as margin requirements and portfolio reconciliation. As a result, financial institutions continue to have large uncleared portfolios of trades in addition to their cleared portfolios.
26. When responding to previous ESMA consultations on the clearing obligation, several respondents mentioned PTRR services and commented on the need to exempt a range

of trades concluded in certain scenarios, *including trades generated as part of post trade risk reducing initiatives such as multi-portfolio compression runs or counterparty risk rebalancing*<sup>16</sup>. However, due to the wording in EMIR, ESMA did not at this time have a mandate to consider conditions leading to a different treatment for such transactions.

### 3.4.2 Reporting of PTRR transactions under EMIR

27. Although ESMA's mandate to produce this report does not mention the reporting obligation, it seems important to remind that EMIR contains requirements to report all derivatives entered into under EMIR, including derivatives that would be generated as a result of running PTRR services on portfolios. The reporting requirements under EMIR may be found in the RTS on the minimum details of the data to be reported to trade repositories<sup>17</sup> and the ITS on the format and frequency of trade reports to trade repositories, where the "compression" flag was populated initially in the Field 11 of the Table 2 (Common data)<sup>18</sup> but has been moved to Field 16<sup>19</sup>.
28. Following the amendments to EMIR introduced by Refit, ESMA is in the process of assessing technical standards on reporting, including the reporting of derivatives that derive from PTRR services<sup>20</sup>. The ability to link reports of different derivatives related to the same business events is currently limited and information concerning the nature of a business event will be crucial to understand the relationship between the linked derivatives not only in the event of compression, but also where any derivatives are terminated or created due to a PTRR event.

## 3.5 MiFIR and portfolio compression

29. MiFIR<sup>21</sup> and the related delegated regulation with regard to portfolio compression<sup>22</sup> contain a number of provisions that relate to the provision of, and participation in, portfolio compression services by investment firms and market operators.

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<sup>16</sup> See ESMA Final Report Draft technical standards on the Clearing Obligation – Interest Rate OTC Derivatives, 1 October 2014. [https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2014-1184\\_final\\_report\\_clearing\\_obligation\\_irs.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2014-1184_final_report_clearing_obligation_irs.pdf)

<sup>17</sup> Commission Delegated Regulation (EU) No 148/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards on the minimum details of the data to be reported to trade repositories. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0148&from=GA>

<sup>18</sup> Commission Implementing Regulation No 1247/2012 of 19 December 2012 laying down implementing technical standards with regard to the format and frequency of trade reports to trade repositories.

11 Compression: Y = if the contract results from compression; N= if the contract does not result from compression.

<https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:352:0020:0029:EN:PDF>

<sup>19</sup> Commission Implementing Regulation (EU) 2017/105 of 19 October 2016 amending Implementing Regulation (EU) No 1247/2012 laying down implementing technical standards with regard to the format and frequency of trade reports to trade repositories according to Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories requires the compression flag to be indicated in Field 16.

<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0105&from=EN>

<sup>20</sup> Technical standards on reporting, data quality, data access and registration of Trade Repositories under EMIR REFIT (ESMA74-362-47).

<sup>21</sup> Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 ("MiFIR").

<sup>22</sup> Commission Delegated Regulation (EU) 2017/567 of 18 May 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to definitions, transparency, portfolio compression and supervisory

**Article 31 Portfolio Compression**

1. When providing portfolio compression, investment firms and market operators shall not be subject to the best execution obligation in Article 27 of Directive 2014/65/EU, the transparency obligations in Articles 8, 10, 18 and 21 of this Regulation and the obligation in Article 1(6) of Directive 2014/65/EU. The termination or replacement of the component derivatives in the portfolio compression shall not be subject to Article 28 of this Regulation.
2. Investment firms and market operators providing portfolio compression shall make public through an APA the volumes of transactions subject to portfolio compressions and the time they were concluded within the time limits specified in Article 10.
3. Investment firms and market operators providing portfolio compressions shall keep complete and accurate records of all portfolio compressions which they organise or participate in. Those records shall be made available promptly to the relevant competent authority or ESMA upon request.
4. The Commission may adopt by means of delegated acts in accordance with Article 50, measures specifying the following:
  - (a) the elements of portfolio compression,
  - (b) the information to be published pursuant to paragraph 2,in such a way as to make use as far as possible of any existing record keeping, reporting or publication requirements.

30. Based on a technical advice prepared by ESMA<sup>23</sup>, Article 17 of Commission delegated regulation (EU) 2017/567<sup>24</sup> sets out the elements of portfolio compression. In 2017 ISDA developed a Portfolio Compression Agreement to help the industry fulfilling the requirement set in Article 17(2) of the delegated act<sup>25</sup>.

**Commission delegated regulation (EU) 2017/567****Article 17 Elements of Portfolio compression**

(Article 31(4) of Regulation (EU) No 600/2014)

1. For the purposes of Article 31(1) of Regulation (EU) No 600/2014, investment firms and market operators providing portfolio compression shall fulfil the conditions in paragraphs 2 to 6.
2. Investment firms and market operators shall conclude an agreement with the participants to the portfolio compression providing for the compression process and its legal effects, including identifying the point in time at which each portfolio compression becomes legally binding.
3. The agreement referred to in paragraph 2 shall include all relevant legal documentation describing how derivatives submitted for inclusion in the portfolio compression are terminated and how they are replaced by other derivatives.
4. Before each compression process is initiated, investment firms and market operators providing portfolio compression shall:
  - (a) require each participant to the portfolio compression to specify the participant's risk tolerance including specifying a limit for counterparty risk, a limit for market risk and a cash payment tolerance. Investment firms and market operators shall respect the risk tolerance specified by the participants in the portfolio compression;
  - (b) link the derivatives submitted for portfolio compression and submit to each participant a portfolio compression proposal that includes the following information:
    - (i) the identification of the counterparties affected by the compression,
    - (ii) the related change to the combined notional value of the derivatives,

measures on product intervention and positions. ESMA provided a technical advice to the EC [https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-1569\\_final\\_report\\_-\\_esmas\\_technical\\_advice\\_to\\_the\\_commission\\_on\\_mifid\\_ii\\_and\\_mifir.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-1569_final_report_-_esmas_technical_advice_to_the_commission_on_mifid_ii_and_mifir.pdf)

<sup>23</sup> [https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-1569\\_final\\_report\\_-\\_esmas\\_technical\\_advice\\_to\\_the\\_commission\\_on\\_mifid\\_ii\\_and\\_mifir.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-1569_final_report_-_esmas_technical_advice_to_the_commission_on_mifid_ii_and_mifir.pdf)

<sup>24</sup> [https://eur-lex.europa.eu/eli/reg\\_del/2017/567/oj](https://eur-lex.europa.eu/eli/reg_del/2017/567/oj)

<sup>25</sup> <https://www.isda.org/2017/11/28/isda-2017-portfolio-compression-agreement/>

(iii) the variation of the combined notional amount compared to the risk tolerance specified.

5. In order to adjust the compression to the risk tolerance set by the participants to the portfolio compression and in order to maximise the efficiency of the portfolio compression, investment firms and market operators may grant participants additional time to add derivatives eligible for termination or reduction.

6. Investment firms and market operators shall only perform the portfolio compression once all participants to the portfolio compression have agreed to the portfolio compression proposal.

## 4 Market use of PTRR services today

31. In order to assess the scope of PTRR services provided and the future of such services with or without an exemption to the clearing obligation, ESMA would encourage PTRR service providers to provide the relevant data of the PTRR services conducted today and, where possible, whether those numbers would be expected to change if there was an exemption to the clearing obligation.

**Question 12: Please provide data (number of trades and notional compressed, amount of initial margin reduction, number of counterparties regularly using PTRR services, other metrics) per type of PTRR service, with as much granularity as possible (per entity, per asset class/currency, per run, over the years and over the past year, etc.) and the related explanations on how PTRR services are used.**

**Question 13: Please also, where possible, provide data whether those numbers would be expected to change if there was an exemption to the clearing obligation.**

## 5 Is the clearing obligation hampering the use of PTRR services?

32. After considering what PTRR services are and why they are used in the market this section is looking into whether the clearing obligation in some cases might limit the use of PTRR services.

### 5.1 The allocation of PTRR transactions to cleared portfolios

33. In order for risk-reduction services to work effectively and reduce risk related to a portfolio, the portfolio will need to have the same counterparties after compression. However, mandatory clearing would, for portfolio compression (e.g. legacy transactions), allocate the replacement transaction to a cleared netting set i.e. with the CCP as the counterparty to the trade, meaning that the PTRR trade would not end up replacing the positions within the uncleared set which it was supposed to following the compression. For other PTRR services such as rebalancing and optimisation services, where the offsetting overlay trade is not subject to the clearing obligation (for instance if a swaption or a swap in a currency not in scope of the clearing obligation is used), the trade can remain within the uncleared portfolio. However, where the PTRR trade is subject to the clearing obligation, it will be allocated to the cleared portfolio losing the link with the underlying portfolio it should be reducing the risk of.



34. To address the issue of the allocation of PTRR transactions to cleared portfolios, ie “broken netting sets” or detached rebalancing transactions, it has been raised, that the replacement or rebalancing trades should not be subject to the clearing obligation as the transaction is only entered into as part of a PTRR exercise, such as portfolio compression and would not have occurred had the PTRR exercise (replacement or rebalancing transactions) not been undertaken.

## **5.2 PTRR services avoiding the use of derivatives subject to the clearing obligation**

35. Considering the issue with netting sets, legacy trades and rebalancing transactions, PTRR services resulting in transactions subject to the clearing obligation may today either be avoided by not undertaking the PTRR exercise or by using transactions not subject to the clearing obligation. The use of transactions not subject to the clearing obligation might though raise some questions from a regulatory perspective. The question is if PTRR services executed using transactions not subject to the clearing obligation would result in risks that would not be present if transactions subject to the clearing obligation could be used.

**Question 14: Do you think an exemption from the clearing obligation for transactions resulting from PTRR services would increase the use of PTRR services? Please explain.**

**Question 15: Do you think an exemption from the clearing obligation is not needed for legacy portfolios and PTRR services generally? To what extent can the use of plain vanilla transactions in PTRR services be replaced with the use of non-plain vanilla transactions, or should this be avoided? Please explain.**

## **6 Risks with an exemption from the clearing obligation**

### **6.1 The G20 Commitments and the global position**

36. Would an exemption challenge the declaration of mandatory clearing? The G20 commitments to the trading obligation and the clearing obligation are applicable where suitable and it is not a requirement to clear all transactions. It may be noted, as further specified below, that several countries have exempted transactions resulting from portfolio compression from the clearing obligation.

**Question 16: Would an exemption to the clearing obligation contradict the G20 commitments? Please explain.**

### **6.2 Circumvention of the clearing obligation**

37. ESMA notes that exempting trades, which would otherwise be subject to the clearing obligation and be cleared, might incentivise market participants to use this technique as a way to avoid clearing. EMIR Refit requires that before granting any clearing exemption,

regulators must assess if such exemption would lead to a circumvention of the clearing obligation. To assess the risks of circumvention by allowing certain PTRR transactions to be exempted from the clearing obligation is difficult, mainly for the obvious reason that the PTRR transactions would most likely not have occurred at all today due to the clearing obligation.

**Question 17: How could an exemption to the clearing obligation for PTRR trades lead to a circumvention of the clearing obligation? Please explain.**

### **6.3 Would a clearing exemption discourage central clearing?**

38. There are strong incentives to clear transactions including margin requirements and capital requirements for non-centrally cleared transactions. An exemption to the clearing obligation would not exempt trades from the framework applicable to non-cleared transactions and trades generated from PTRR services would be subject to the risk mitigation techniques requirements under Article 11 of EMIR (including bilateral margining), as mentioned in the Introduction. This may also have an impact on the incentive to use PTRR services compared to using cleared transactions depending on the applicable overall costs or cost reduction achieved. The more costly the uncleared transactions become, the lesser incentive to avoid the clearing obligation where a new replacement/rebalancing trade is entered into.

**Question 18: Would you consider introducing an exemption to the clearing obligation as an incentive not to clear transactions that technically are covered by the clearing obligation. If yes, why?**

### **6.4 Reduced collateral**

39. Market participants are incentivised to optimise or reduce collateral as this is costly. The bilateral market has been calculating collateral on net basis and managed risks and exposures through amendments, terminations, etc. One aspect raised in relation to PTRR services is the concern that by using compression and risk mitigation through offsetting trades, the market might become “under collateralised”, but due to the reduced exposure the collateral would still be the correct amount as required under the regulation.
40. It is also noted that IOSCO notes that PTRR services aim to reduce “outstanding gross notional value of non-centrally cleared OTC derivatives transactions, allowing for increased capital liquidity and efficiency”.

**Question 19: Are there risks with reducing collateral? Even if complying with regulatory requirements, could this lead to such capital being used to increase risks, possibly systemic risks?**

## 7 International position regarding the application of the clearing obligation to PTRR transactions

41. Several third countries have adopted an exemption to the clearing obligation, primarily in ESMA's understanding covering portfolio compression. Such exemptions seem qualified by certain conditions to be fulfilled, either as part of the definition of which services that can benefit from such exemption or as listed conditions. Hence, to consider an exemption under EMIR will also depend on level playing field considerations, i.e. ensuring counterparties within the Union are on similar terms with counterparties in other countries outside the Union as limitations to the use of PTRR services may lead to higher costs and/or higher risks in the portfolios within the Union compared to outside the Union.
42. This part provides a high-level summary of the approach taken by some of those jurisdictions in relation to PTRR services (some additional details may be found in the Matrix in Annex 2).

In the **US** an exemption to the clearing obligation for portfolio compression services is in force since 2013 in the form of a no-action letter<sup>26</sup>, where the Division of Clearing and Risk at the CFTC does not recommend to take an enforcement action against a person for failure to comply with the requirement to clear an amended swap or a replacement swap that is generated as part of a multilateral portfolio compression exercise<sup>27</sup>, provided that certain conditions are met.

In **Australia**, the Australian Securities & Investments Commission (ASIC) in 2015, proposed exemptions from the clearing requirements for derivative transactions that resulted from multilateral trade compression<sup>28</sup> offered by a third party (the multilateral compression exemption)<sup>29</sup>. The exception to the clearing requirement for multilateral portfolio compression was adopted in 2016 by the ASIC Derivative Transaction Rules (Clearing) 2015 and contains several requirements<sup>30</sup>.

In **Canada**, an exemption to the clearing obligation was adopted in 2017<sup>31</sup> for multilateral portfolio compression where a local counterparty is exempt from the application of the

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<sup>26</sup> CFTC Letter No. 13-01 No-Action March 18, 2013 Division of Clearing and Risk, Re: No-Action Relief from Required Clearing for Swaps Resulting from Multilateral Portfolio Compression Exercises

[http://www.lexissecuritiesmosaic.com/gateway/cftc/general-press-releases/letter\\_13-01.pdf](http://www.lexissecuritiesmosaic.com/gateway/cftc/general-press-releases/letter_13-01.pdf)

<sup>27</sup> In the U.S. Commodity Futures Trading Commission (CFTC) Regulation (23.500(h)), multilateral portfolio compression exercise means; "an exercise in which multiple swap counterparties wholly terminate or change the notional value of some or all of the swaps submitted by the counterparties for inclusion in the portfolio compression exercise and, depending on the methodology employed, replace the terminated swaps with other swaps whose combined notional value (or some other measure of risk) is less than the combined notional value (or some other measure of risk) of the terminated swaps in the compression exercise."

<sup>28</sup> "Multilateral Portfolio Compression Cycle means a process under which portfolios of Derivatives between participants in the process are modified to reduce their notional value or terminated and replaced with new Derivatives providing for reduced notional exposures between the participants, conducted for the purposes of reducing operational risk or counterparty credit risk for the participants, for reduced notional exposures between the participants, conducted for the purposes of reducing operational risk or counterparty credit risk for the participants."

<sup>29</sup> <http://download.asic.gov.au/media/3489121/rep460-published-14-december-2015.pdf>

<sup>30</sup> <https://www.legislation.gov.au/Details/F2015L01960>

<sup>31</sup> <https://www.securities-administrators.ca/aboutcsa.aspx?id=1551&terms=94-101>

clearing obligation with respect to a derivative resulting from a multilateral portfolio compression exercise, if certain conditions apply<sup>32</sup>.

In **Hong Kong**, the Securities and Futures Commission adopted Securities and Futures Rules in 2016 containing an exemption from the clearing obligation for transactions resulting from a multilateral portfolio compression cycle subject to certain conditions. Securities and Futures Commission published in March 2019 Q&A<sup>33</sup> on their mandatory clearing regime<sup>34</sup>, providing details on the “Exemption for transactions resulting from multilateral portfolio compression cycle Q30”.

**Singapore** exempts certain contracts from the clearing obligation where the derivative contract is *entered into or amended* as a result of a *multilateral portfolio compression cycle*<sup>35</sup>.

**Question 20: Are there other jurisdictions where PTRR trades have been exempted from the clearing obligation? Please explain the features of any such exemption. Do you use any of those exemptions, and for what type of trades?**

## 8 Possible conditions or requirements for PTRR

43. If an exemption to the clearing obligation was to be granted under EMIR, it could be subject to certain conditions.

### 8.1 List of possible conditions or requirements

44. The following non-exhaustive list of conditions or requirements have been noted in other jurisdictions to apply where an exemption to the clearing obligation is provided for PTRR portfolio compression.

1. Only uncleared transactions should be included in the portfolio for compression;
2. Only multilateral compression can be exempted, i.e. more participants than 2 excluding the service provider;
3. The compression exercise should result in reduced notional and/or risk;
4. The compression exercise should involve the same counterparties as the original transactions being compressed; and
5. The PTRR service provider should be acting independently and PTRR transactions shall be generated in accordance with a multilateral portfolio compression service

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<sup>32</sup> Ontario, National Instrument 94-101 [https://www.osc.gov.on.ca/en/SecuritiesLaw\\_cp\\_20170706\\_94-101\\_mandatory-central-counterparty.htm](https://www.osc.gov.on.ca/en/SecuritiesLaw_cp_20170706_94-101_mandatory-central-counterparty.htm)

<sup>33</sup> <https://www.sfc.hk/web/EN/files/SOM/OTC/FAQ%20Clearing%20Rules%2020190226%20FINAL.pdf>

<sup>34</sup> <https://www.elegislation.gov.hk/hk/cap571AN>

<sup>35</sup> <https://sso.agc.gov.sg/SL-Supp/S134-2019/Published/20190313?DocDate=20190313>

provider's established rules and parameters for multilateral portfolio compression exercises.

45. ESMA would like to further understand if similar requirements would be suitable to apply in relation to an exemption under EMIR for trades resulting from portfolio compression. ESMA would also like to understand if the same conditions should apply to other PTRR services.

**Question 21: Should conditions, similar to the ones as outlined above, apply to a possible exemption under EMIR for PTRR transactions? Should other conditions apply? Would the answer depend on the type of PTRR service? Please explain.**

## **8.2 Potential conditions applicable to PTRR services?**

### 8.2.1 Multilateral portfolio compression

46. As previously noted, portfolio compression can be carried out bilaterally (between two parties in relation to their portfolio with each other) or multilaterally between multiple entities in relation to their portfolios with all of the other counterparties taking part in the compression. It is noted that many jurisdictions only provide an exemption from the clearing obligation in relation to multilateral compression, possibly due to different risk profiles or due to different justifications for an exemption. The question for this paper is if only multilateral portfolio compression should be considered as a PTRR service.

**Question 22: Is there a difference between bilateral and multilateral portfolio compression justifying an exemption to the clearing obligation only to apply for multilateral portfolio compression?**

### 8.2.2 Restriction to portfolio composed of uncleared transactions

47. Some jurisdictions grant an exemption to a trade resulting from compression only when the original portfolio is composed of uncleared trades (including legacy transactions).

**Question 23: Should only uncleared transactions be included in portfolio compression in order to qualify for the clearing exemption? How would a possible limitation to uncleared transactions limit the effectiveness?**

### 8.2.3 Market risk neutral

48. PTRR services should not change the market risk of the portfolio and PTRR exercises should only contain non-price forming trades. However, with the application of tolerances and other adjustments, how is the market risk kept neutral or significantly neutral and how to measure this if such a requirement would apply to PTRR services?

**Question 24: To benefit from an exemption to the clearing obligation, should PTRR trades be strict risk neutral or should there be tolerances for small changes in the risk of portfolios? How would you define what is an acceptably small change in risk?**

#### 8.2.4 Same Counterparties

49. It seems like one of the current requirements in other jurisdictions is that the PTRR exercise should involve the same counterparties as the original transactions being compressed. ESMA would like to further understand if this practice also applies for the PTRR services offered today or possibly to be offered in the future and any risks with deviating from this principle. Can a CCP for example be added to the PTRR exercise even if it is not a party to one of the original trades. Can other counterparties be added to the PTRR exercise to achieve a higher compression or risk reduction?

**Question 25: To benefit from an exemption to the clearing obligation, to what extent should parties to a PTRR exercise be able to be changed, i.e. not limited to the original counterparties? Would the answer depend on the type of PTRR service? Please explain.**

#### 8.2.5 Reduce notional/risk - No participants worse of

50. PTRR services should reduce the risk in the portfolio. Under MiFIR the measurement of the portfolio compression is based on notional amounts<sup>36</sup>.
51. The question is whether all counterparties whose portfolios in which PTRR transactions are booked need to demonstrate a reduction in notional amount and/or risk and whether there should be a requirement for this to be documented by the PTRR service provider and/or by the participants in the PTRR exercise. A related question is how this risk should be measured as there are a number of ways to measure risk, one being to measure the IM the parties to the PTRR exercises are required to exchange to ensure it is reduced or at least not increased.

**Question 26: Should there be a requirement for PTRR services to reduce risk for a clearing exemption to apply? Should it apply to all PTRR services? If not, please explain why. How would a successful PTRR exercise be measured?**

52. It has been suggested that in the outcome of the PTRR services it is possible that the exposure for one (or more) parties may be increased but on balance, the total exposure is reduced. However, no participant to the PTRR service should be worse off for the transactions included in the PTRR exercise than if the PTRR exercise had not taken place.

**Question 27: Could PTRR services increase exposure or risk on a participant basis? Would the answer depend on the type of PTRR service provided? How should the PTRR service provider limit any possible increase in notional amount or risk? Please explain.**

**Question 28: How could a limitation like “no participant worse off” be defined?**

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<sup>36</sup> [https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-1569\\_final\\_report\\_-\\_esmas\\_technical\\_advice\\_to\\_the\\_commission\\_on\\_mifid\\_ii\\_and\\_mifir.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-1569_final_report_-_esmas_technical_advice_to_the_commission_on_mifid_ii_and_mifir.pdf)

## 8.3 PTRR service providers

### 8.3.1 PTRR service providers acting independently

53. A key consideration is *how* to regulate the PTRR services provided and *how* to avoid inappropriate influence of the participants over the PTRR service provider. If the PTRR provider was not bound by conditions, there is the risk that participants could cherry-pick which transactions submitted to the PTRR service provider would eventually get executed (and which not). Similarly, if there were no requirements on the PTRR exercise to not increase the risk in portfolios, then there would be a risk that PTRR services could be used to add trades under the perception that they are exempted from the clearing obligation just by the fact of being part of a PTRR exercise. A way to mitigate these risks (and this is already noted under MiFIR) is to provide clear remits and requirements to PTRR services to ensure they are not used to avoid the clearing obligation.
54. The process today seems to be that the participating counterparties decide on the transactions to be included in the portfolio which is submitted to the PTRR exercise. Once the parties have submitted their portfolios, it is understood that they have no further influence over the exercise. With some PTRR services such as portfolio compression, the parties may set tolerance levels to provide the remits of the exercise, but the participants influence is expected to end with the submission of the portfolio, as then it is the PTRR service provider who applies its algorithm to complete the PTRR exercise. This means that after the PTRR service provider runs the PTRR exercise on such portfolio, the counterparties may or may not undertake the suggested resulting PTRR transactions, but they cannot influence or change the result of running the PTRR service provider's algorithms. The service provider analyses the portfolios of the participants and publishes the optimal solution. The outcome depends on which method the PTRR service provider will use.
55. Hence, one requirement for the provision of PTRR services could be that the transactions shall be generated in accordance with a multilateral portfolio compression service provider's *established rules and parameters* for multilateral portfolio compression exercises and the exercise shall be conducted *independently* by the PTRR service provider acting as a third-party.

**Question 29: How should it be ensured that PTRR service providers are independent in their assessment? Should the conditions imposed on the providers of PTRR services include requirements on governance of the algorithms to ensure the definition and the setting of parameters takes place with minimum influence from market participants? Should algorithms run with minimum manual intervention? Any other conditions or structural requirements that should apply?**

### 8.3.2 Supervision of PTRR service providers

56. In view of the role PTRR service providers are playing and the size of the cycles that are being run, one consideration is whether PTRR services are also becoming, or already are, systemically important for the financial stability and should be supervised

accordingly. A PTRR service provider is not comparable to CCPs as the latter are regulated in terms of risk management and systemic risk prevention. A CCP also assumes counterparty risks as it becomes the counterparty to the trades whilst a PTRR service provider tends to, for example, provide a package of transactions to be executed by the counterparties to the PTRR exercise to achieve the intended risk reduction. Hence, depending on the level of involvement of the PTRR service provider in the designation, application and execution of PTRR transactions, different rules and regulation may be relevant to apply on such PTRR service providers.

57. Today some PTRR service providers in the Union are authorised under MiFID as an "Investment firm" meaning "any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis<sup>37</sup>" but there is no specific authorisation for providing PTRR services.
58. The PTRR services contain some main algorithms or methodologies to analyse portfolios and present a result to achieve the sought-after risk-reduction. Should such algorithms be subject to a specific governance regime? Would a specific framework applicable to PTRR service providers as a new authorisation procedure add value or would it hamper the development of future PTRR services? It is noted that such an authorisation should probably apply to all PTRR services, and not be limited to PTRR services that contain OTC transactions exempted (assuming here an exemption is provided) from the clearing obligation.

**Question 30: Do you consider that a PTRR service provider should be specifically licenced or authorised? Would this depend on the remits of the services provided? Would it be sufficient to provide requirements on the service provided, i.e. on transaction level rather than entity level? What do you see as the benefits of regulating PTRR services? Would this create any impediment or barriers?**

## 9 Cost Benefit Assessment

59. In order to assess the effects of an exemption to the clearing obligation, ESMA would like to receive data and other information on the possible costs or benefits of an exemption to the clearing obligation.

**Question 31: What would be the cost-benefit of exempting PTRR transactions (replacement and risk mitigation services through offsetting trades such as rebalancing) from the clearing obligation?**

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<sup>37</sup> Article 4(1) of MiFID.



## 10 Annex 1 - Summary of questions

**Question 1: Would you agree with the description of the benefits (i.e. reduced risks) derived from PTRR services? Are there any missing? Could PTRR services instead increase any of those risks? Are there any other risks you see involved in using PTRR services?**

**Question 2: Would you agree with this description of portfolio compression? Please explain the different compression services that are offered and how they may differ from the description above. Are there today viable alternatives to using PTRR services to achieve a similar outcome?**

**Question 3: Without changing the market risk of the portfolios, how different can the transactions included in the portfolio compression exercise be? Would the market risk be changed at all by the applied tolerances and if yes, how can the portfolio remain market neutral? What tolerance levels are often applied and could/should restrictions be placed on tolerances?**

**Question 4: Should there be a clearing exemption for PTRR trades that are a direct result from a portfolio compression? If not, why? Is there a difference between bilateral and multilateral portfolio compression for the sake of an exemption?**

**Question 5: Would you agree with this description of PTRR Services? What other forms of PTRR services exist? What do they do? How do they work? Are there any other viable alternatives to PTRR services, if yes, why are they not sufficient?**

**Question 6: Without changing the market risk of the portfolios, how different can the transactions included in the PTRR exercise be? What tolerance levels are often applied and what restrictions could/should restrictions be placed on tolerances (if applies)?**

**Question 7: Is the requirement under EMIR of portfolio compression sufficient to mitigate the risk of build-up of transactions and how is the market managing this risk today?**

**Question 8: Based on all of the above, how would you define (algorithm based, second order risk, market neutral) PTRR services that cover all of the relevant aspects?**

**Question 9: Should there be an exemption from the clearing obligation for PTRR trades (other than portfolio compression) that are a direct result from a PTRR exercise? If not, why?**

**Question 10: Is there a PTRR service today including offsetting transactions with a CCP?**

**Question 11: Assuming there would be an exemption to the clearing obligation:**

- (i) Could PTRR services conduct offsetting opposite trades in the counterparty's cleared portfolio and if yes, should it be mandatory to enter into such offsetting transactions?
- (ii) Would the PTRR transaction in the non-cleared portfolio then remain between the counterparties or be terminated (netted)?
- (iii) Question 12: Please provide data (number of trades and notional compressed, amount of initial margin reduction, number of counterparties regularly using PTRR services, other metrics) per type of PTRR service, with as much granularity as possible (per entity, per asset class/currency, per run, over the years and over the past year, etc.) and the related explanations on how PTRR services are used.

**Question 13:** Please also, where possible, provide data whether those numbers would be expected to change if there was an exemption to the clearing obligation.

**Question 14:** Do you think an exemption from the clearing obligation for transactions resulting from PTRR services would increase the use of PTRR services? Please explain.

**Question 15:** Do you think an exemption from the clearing obligation is not needed for legacy portfolios and PTRR services generally? To what extent can the use of plain vanilla transactions in PTRR services be replaced with the use of non-plain vanilla transactions, or should this be avoided? Please explain.

**Question 16:** Would an exemption to the clearing obligation contradict the G20 commitments? Please explain.

**Question 17:** How could an exemption to the clearing obligation for PTRR trades lead to a circumvention of the clearing obligation? Please explain.

**Question 18:** Would you consider introducing an exemption to the clearing obligation as an incentive not to clear transactions that technically are covered by the clearing obligation. If yes, why?

**Question 19:** Are there risks with reducing collateral? Even if complying with regulatory requirements, could this lead to such capital being used to increase risks, possibly systemic risks?

**Question 20:** Are there other jurisdictions where PTRR trades have been exempted from the clearing obligation? Please explain the features of any such exemption. Do you use any of those exemptions, and for what type of trades?

**Question 21:** Should conditions, similar to the ones as outlined above, apply to a possible exemption under EMIR for PTRR transactions? Should other conditions apply? Would the answer depend on the type of PTRR service? Please explain.

**Question 22: Is there a difference between bilateral and multilateral portfolio compression justifying an exemption to the clearing obligation only to apply for multilateral portfolio compression?**

**Question 23: Should only uncleared transactions be included in portfolio compression in order to qualify for the clearing exemption? How would a possible limitation to uncleared transactions limit the effectiveness?**

**Question 24: To benefit from an exemption to the clearing obligation, should PTRR trades be strict risk neutral or should there be tolerances for small changes in the risk of portfolios? How would you define what is an acceptably small change in risk?**

**Question 25: To benefit from an exemption to the clearing obligation, to what extent should parties to a PTRR exercise be able to be changed, i.e. not limited to the original counterparties? Would the answer depend on the type of PTRR service? Please explain.**

**Question 26: Should there be a requirement for PTRR services to reduce risk for a clearing exemption to apply? Should it apply to all PTRR services? If not, please explain why. How would a successful PTRR exercise be measured?**

**Question 27: Could PTRR services increase exposure or risk on a participant basis? Would the answer depend on the type of PTRR service provided? How should the PTRR service provider limit any possible increase in notional amount or risk? Please explain.**

**Question 28: How could a limitation like “no participant worse off” be defined?**

**Question 29: How should it be ensured that PTRR service providers are independent in their assessment? Should the conditions imposed on the providers of PTRR services include requirements on governance of the algorithms to ensure the definition and the setting of parameters takes place with minimum influence from market participants? Should algorithms run with minimum manual intervention? Any other conditions or structural requirements that should apply?**

**Question 30: Do you consider that a PTRR service provider should be specifically licenced or authorised? Would this depend on the remits of the services provided? Would it be sufficient to provide requirements on the service provided, i.e. on transaction level rather than entity level? What do you see as the benefits of regulating PTRR services? Would this create any impediment or barriers?**

**Question 31: What would be the cost-benefit of exempting PTRR transactions (replacement and risk mitigation services through offsetting trades such as rebalancing) from the clearing obligation?**

## 11 Annex 2: High-level matrix over exemptions for portfolio compression in other jurisdictions

Country	Applied conditions and independent service provider	Portfolio of only uncleared transactions	Only multilateral compression	Same CPs	Reduce notional	Reduce risk
US	<p>Each amended swap(s) or replacement swap(s) generated by the multilateral portfolio compression exercise must:</p> <ul style="list-style-type: none"> <li>- be generated in accordance with a multilateral portfolio compression service provider's established rules and parameters for multilateral portfolio compression exercises; and</li> <li>- the "multilateral portfolio compression exercise" generating the amended and replacement swaps must meet the definition set forth in Commission regulation 23.500(h).</li> </ul> <p>Once the original swaps have been selected and submitted by market participants as part of the multilateral portfolio compression exercise, the multilateral portfolio compression methodology does not permit participants to specify which swaps may be amended or replaced.</p>	<p>2. No original swap submitted by market participants as part of the multilateral portfolio compression exercise shall include any swap that has been cleared by a DCO.</p> <p>3. No original swap submitted by market participants as part of the multilateral portfolio compression exercise shall include any swap that is required to be cleared under 2(h)(1)(A) of the CEA and part 50 of Commission regulations because it was executed on or after an applicable compliance date.</p>	<p>"[...] and must involve more than two market participants."</p>	<p>b. be entered into between the same counterparties as the original swap(s) that is amended or terminated;</p>	<p>c. with the exception of reducing the notional amount, have the same material terms as the original swap(s), as defined in part 45 of Commission regulations,<sup>10</sup> including the reference entity, the maximum maturity of the swap, and the average weighted maturity of the swap; and</p> <p>d. be entered into for the sole purpose of reducing operational or counterparty credit risk.</p>	<p>"replace the terminated swaps with other swaps whose combined notional value (or some other measure of risk) is less than the combined notional value (or some other measure of risk) of the terminated swaps in the compression exercise"</p>
Australia	<p>(a) the Clearing Transaction is entered into by the Clearing Entity as a result of the Clearing Entity modifying or terminating and replacing Derivatives under</p>	<p>(b) for each of the Derivatives that was modified, or terminated and replaced—entry into the Derivative was not a Clearing Transaction that</p>	<p>"the Clearing Transaction is entered into by the Clearing Entity as a result of the Clearing Entity modifying or terminating and replacing Derivatives under a</p>	<p>(c) the Clearing Transactions entered into by the Clearing Entity as a result of the Multilateral Portfolio Compression Cycle are</p>	<p>Multilateral Portfolio Compression Cycle means a process under which portfolios of Derivatives between participants in the process are modified to</p>	<p>"conducted for the purposes of reducing operational risk or counterparty credit risk for the participants. for reduced notional exposures between the participants, conducted</p>

	<p>a Multilateral Portfolio Compression Cycle;  (d) the Multilateral Portfolio Compression Cycle was conducted in accordance with the rules of a third-party operator of Multilateral Portfolio Compression Cycles and involved more than two participants, none of which was the operator;  (e) the Multilateral Portfolio Compression Cycle was conducted in compliance with the counterparty credit risk tolerance levels set by the participants in the Multilateral Portfolio Compression Cycle.</p>	<p>was required to be Cleared Through a Clearing Facility in accordance with Rule 2.1.1 or sub-rule 2.1.6(2); and</p>	<p>Multilateral Portfolio Compression Cycle;”</p>	<p>only entered into with persons who were counterparties to those Derivatives; and</p>	<p>reduce their notional value or terminated and replaced with new Derivatives providing for reduced notional exposures between the participants</p>	<p>for the purposes of reducing operational risk or counterparty credit risk for the participants.”</p>
Canada	<p>(e) the multilateral portfolio compression exercise is conducted by an independent third-party</p>	<p>(b) the existing derivatives do not include a mandatory clearable derivative entered into after the effective date on which the class of derivatives became a mandatory clearable derivative;  (c) the existing derivatives were not cleared by a clearing agency or clearing house;</p>	<p>Multilateral portfolio compression exemption in National Instrument 94-101 and (a) the mandatory clearable derivative is entered into as a result of more than 2 counterparties changing or terminating and replacing existing derivatives;</p>	<p>(d) the mandatory clearable derivative is entered into by the same counterparties as the existing derivatives;</p>		
Hong Kong	<p>Exempted “if the transaction is entered into by the person (i) as a result of a multilateral portfolio compression cycle that meets the requirements referred to in subrule (2);  (2) The requirements are that the multilateral portfolio compression cycle—  (a) was conducted in accordance with the rules of an</p>	<p>multilateral portfolio compression cycle means a process applied to portfolios of OTC derivative transactions.</p>	<p>b) the multilateral portfolio compression cycle [...] (ii) involves more than 2 participants and the operator cannot be a participant (i.e. a bilateral compression will not be able to benefit from the exemption);</p>	<p>Exempted “if the transaction is entered into by the person [...] (ii) with a participant in the multilateral portfolio compression cycle that was a counterparty to one or more of the compressed transactions;”</p>	<p>Multilateral portfolio compression cycle means a process applied to portfolios of OTC derivative transactions between participants in the process—  (a) under which some or all of the transactions are (i) modified to reduce their notional value; or  (ii) terminated and replaced with one or more new OTC derivative transactions which</p>	<p>Multilateral portfolio compression cycle means a process applied to portfolios of OTC derivative transactions between participants in the process [...] (b) that is conducted for the purposes of reducing operational risk or counterparty credit risk for the participants.</p>

	operator of multilateral portfolio compression cycles; (b) involved more than 2 participants, none of which was the operator of the cycle; and (c) was conducted in compliance with the counterparty credit risk tolerance levels set by the participants in the cycle.				have the effect of reducing exposures between or among the participants;	
Singapore	(d) that is conducted by an operator engaged by parties to derivatives contracts contained in the portfolio; and (f) that is conducted — (i) in accordance with rules set by the operator; and (ii) in compliance with a counterparty credit risk tolerance level set by all the participants”.		(e) in which there are at least 3 participants;”	(b) if the derivatives contract is entered into [...] (ii) with a participant in the portfolio compression cycle that was a party to one or more of the compressed derivatives contracts under the cycle.	The definition of multilateral portfolio compression cycle means a process: “(a) that is applied to a portfolio of derivatives contracts; (b) under which some or all of the derivatives contracts in the portfolio are — (i) modified to reduce their notional amount; or (ii) terminated and replaced with one or more new derivatives contracts which have the effect of reducing notional exposures between the participants;	The definition of multilateral portfolio compression cycle means a process: (c) that is conducted for the purposes of reducing counterparty risk or operational risk for the participants;