

Consultation Paper

Regulatory Standards on the requirements for Post-Trade Risk Reduction services for the purpose of the clearing obligation exemption under EMIR

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:

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

ESMA will consider all comments received by 20 April 2026.

All contributions should be submitted online at 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 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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References, definitions, acronyms

Algorithm	The pre-agreed rules of the PTRR exercise, including methods and algorithms
CCP	Central Counterparty
CDR 2013/149	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
CDR 2017/565	Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive
CDR 2017/567	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 measures on product intervention and positions
CDR 2017/583 (or RTS2)	Commission Delegated Regulation (EU) 2017/583 of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives
CDR 2017/587 (or RTS 1)	Commission Delegated Regulation (EU) 2017/587 of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and

	investment firms in respect of shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments and on transaction execution obligations in respect of certain shares on a trading venue or by a systematic internaliser
CDR 2017/590	Commission Delegated Regulation (EU) 2017/590 of 28 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the reporting of transactions to competent authorities
CDR 2022/1855 or CDR on EMIR Reporting	Commission Delegated Regulation (EU) 2022/1855 of 10 June 2022 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards specifying the minimum details of the data to be reported to trade repositories and the type of reports to be used
CO	Clearing Obligation
CP	Consultation Paper
ESMA	European Securities and Markets Authority
EMIR	Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories
EMIR 3	Regulation (EU) 2024/2987 of the European Parliament and of the Council of 27 November 2024 amending Regulations (EU) No 648/2012, (EU) No 575/2013 and (EU) 2017/1131 as regards measures to mitigate excessive exposures to third-country central counterparties and improve the efficiency of Union clearing markets
European Commission or Commission	The European Commission
ESMA 2020 PTRR service Report	ESMA Report to the Commission on PTRR services with regards to the clearing obligation 10 November 2020 ESMA 70-156-3351
FIRDS	Financial Instruments Reference Database
FITRS	Financial Instruments Transparency System
IOSCO PTRRS Report	IOSCO Final Report on PTRRS: sound practices for consideration FR/10/24 November 2024
LEI	Legal entity identifier

MAR Guidelines on Delayed Disclosure	ESMA's MAR Guidelines on Delay in the disclosure of inside information and interactions with prudential supervision (13/04/2022 - ESMA70-159-4966).
Markets in Financial Instruments Directive II or MiFID II	Directive 2014/65/EU of the European Parliament and the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU
Markets in Financial Instruments Regulation or MiFIR	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 Review	Regulation (EU) 2024/791 of the European Parliament and of the Council of 28 February 2024 amending Regulation (EU) No 600/2014 as regards enhancing data transparency, removing obstacles to the emergence of consolidated tapes, optimising the trading obligations and prohibiting receiving payment for order flow
MiFIR Exemptions	The exemption provided by Article 31 of MiFIR from the derivative trading obligation, the transparency requirements and the best execution verification for transactions resulting from PTRR exercises
MiFIR DA amending CDA 2017/567	Commission Delegated Regulation (EU) [...] amending Delegated Regulation (EU) 2017/567 as regards the obligation to provide market data on a reasonable commercial basis, the determination of what constitutes a liquid market for equity instruments, and the definition of and disclosure for post-trade risk reduction services
PTRR	Post Trade Risk Reduction
PTRR exemption	The exemption provided by Article 4b of EMIR to the clearing obligation for transactions resulting from PTRR exercises
PTRR ID	The PTRR Identifier described in Article 7 of the CDR on EMIR Reporting
RTS	Regulatory Technical Standards
SBR	Simplification and burden reduction
TFEU	Treaty of the Functioning of the European Union

1 Executive Summary

Reasons for publication

On 4 December 2024, EMIR 3 was published in the official journal of the European Union and entered into force 20 days after publication. EMIR 3 sets out, amongst others, measures to improve the attractiveness of EU cleared markets, to enhance the resiliency of the EU clearing system and to reduce excessive reliance on third-country CCPs.

EMIR 3 introduces an exemption from the CO for transactions resulting from PTRR services, subject to certain requirements. To further specify the requirements and conditions for such exemption, EMIR 3 mandates ESMA to develop draft RTS.

This CP covers the mandate under EMIR for the RTS on the PTRR exemption. In addition, the CP presents some considerations as regards the transactions to be recorded for the purposes of the exemption introduced by the MiFIR Review to the transparency requirements, the derivative trading obligation and best execution regarding PTRR services.

Contents

After an overview on the legal provisions applicable to the PTRR services, both under EMIR and MiFIR in section 3, the CP brings forward a proposal for the draft RTS under EMIR in section 4.

The proposal first describes the requirements for the types of services eligible to the PTRR exemption; notably, compression, portfolio rebalancing and basis risk optimisation. In addition, it elaborates on the requirements of market risk neutrality and risk reduction applicable to all the types of PTRR services for the purposes of the exemption.

The proposal also sets forth the framework for the PTRR service providers to operate for the purposes of the exemption, addressing different aspects of the PTRR service provisions, including transparency towards participants, the algorithm, the execution of the PTRR exercise, the controls to be performed, and record keeping. In addition, the draft RTS indicate how the monitoring of the application of the PTRR exemption should take place.

The proposal aims to achieve SBR through several aspects. First of all, the development of the draft RTS focused mainly on the requirements needed to prevent the risks arising from the PTRR exemption use, and in particular the circumvention of the CO. In addition, to further decrease the regulatory burden for market participants, the proposal takes into consideration the provisions already applicable to PTRR service providers and users under MiFID, MiFIR and EMIR. For example, the draft RTS consider that pursuant to EMIR the

PTRR service providers need to be MiFID authorised firms, and thus it avoids additional requirements when the applicable MiFID provisions are sufficient to ensure compliance with the EMIR requirements for the purposes of the PTRR exemption (e.g. conflicts of interest). Furthermore, following the entry into force of EMIR 3, the new PTRR exemption regime started to apply and has been used by providers and users of such service. ESMA has worked with NCAs to take stock of this entry into application of the EMIR 3 PTRR service regime, by collecting information on the PTRR services currently used. ESMA has taken into account this experience and this information when developing the proposal. Notably, the proposal includes and leverages on the market practices which already provide safeguards for the use of PTRR services.

The next section, Section 5, deals with MiFIR rather than EMIR and thus is not reflected in the RTS proposal. It contains some considerations as regards the transactions to be recorded for the purposes of the exemption under MiFIR for PTRR services.

Finally, Section 6 includes the annexes with (i) the list of all questions formulated in this consultation, (ii) the draft regulatory technical standards, and (iii) a table enabling a comparison between the IOSCO recommendations regarding the PTRR services, and the requirements set forth in the related EU legal provisions, including the draft RTS.

Next Steps

ESMA will consider the feedback received to this CP in Q2 2026 and expects to publish a final report and submit the draft RTS to the Commission for endorsement in Q4 2026.

2 Introduction

1. Post Trade Risk Reduction (PTRR) services aim to reduce risks in derivatives portfolios, without altering the market risk of the portfolios, and using non-price forming transactions.
2. They include services such as *portfolio compression*, which reduces the number of transactions by replacing, or terminating partially or fully offsetting transactions to lower operational risk; or *portfolio rebalancing*, which introduces additional offsetting transactions among participants to reduce the counterparty risk.
3. PTRR services are generally provided by third-party service providers, who apply an algorithm to identify the transactions to be terminated and/or generated in the portfolios submitted to the exercise in order to reduce risk.
4. In its 2020 Report to the Commission on PTRR services with regards to the clearing obligation (ESMA 2020 PTRR services Report)¹, ESMA noted that PTRR services often use complex products that are not subject to the clearing obligation to avoid the clearing funding costs, as well as the operational and legal burdens connected to clearing. The deployment of PTRR services for complex products however limits the use of these services to more sophisticated financial market participants. ESMA thus recommended the adoption of an exemption regime from the clearing obligation (CO), to permit the use of more standardised products in PTRR services and ultimately, extend their use to a larger group of markets participants.
5. In addition, ESMA noted the importance to ensure such exemption is subject to adequate requirements to prevent any specific risk which may arise from the PTRR service use, including a circumvention of the CO.
6. On 7 December 2022, the Commission published a proposal for a review of EMIR, setting out, amongst others, measures to improve the attractiveness of EU cleared markets, to enhance the resiliency of the EU clearing system and to reduce excessive reliance on third-country CCPs. The final legislative text was published in the official journal of the European Union on 4 December 2024 and entered into force 20 days after publication (EMIR 3)².
7. Following the recommendations of the ESMA 2020 PTRR services Report and as agreed by co-legislators during the EMIR 3 negotiations, Article 4b of EMIR 3 introduces a conditioned exemption from the CO for transactions resulting from PTRR services subject

¹ [ESMA70-156-3351 Final Report PTRR Services - Article 85\(3a\) of EMIR](#).

² https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L_202402987.

to certain requirements (PTRR exemption). The PTRR exemption entered into force with EMIR 3 on 24 December 2024.

8. The provisions on PTRR services under EMIR 3 mandate ESMA to develop RTS to further specify the requirements to benefit from the PTRR exemption. Given the immediate entry into force of Level 1, while the RTS are being developed, an interim period, where the PTRR exemption is in force without the RTS further specifying its requirements being applicable, is currently ongoing (the 'PTRR launch'). Following this launch, it should be noted that ESMA has published and maintains the related Register of PTRR service providers³, pursuant to article 4b, paragraph 5 of EMIR.
9. A few months before EMIR 3 entered into force, the MiFIR Review was published in the Official Journal⁴. The new text amended Article 31 of MiFIR to expand the exemption, previously foreseen for compression, from the transparency requirements, the trading obligation and best execution, to a broader range of PTRR services.
10. The new Article 31 of MiFIR contains a mandate for a Delegated Act for the EC to specify a) the PTRR services for the purpose of the exemption and b) the transactions to be recorded under the same provision. On 8 August 2025, the EC published for consultation a proposed delegated act, specifying the PTRR services for the purpose of the exemption under MiFIR ('MiFIR DA amending CDR 2017/567')⁵.
11. On 21 October 2024, ESMA held a roundtable to collect up-to-date information on the PTRR services from a range of users, providers and CCPs in view of the RTS to be drafted pursuant to the EMIR mandate.
12. In addition, in November 2024, IOSCO published a Final Report on PTRR services on sound practices for consideration ('IOSCO PTRRS Report')⁶. Furthermore, in April 2025, the FCA Published the Policy Statements on the derivative trading obligation and PTRR services (PS25/2)⁷, following a Consultation launched in July 2024 (CP24/14)⁸.
13. The objective of this consultation paper (CP) is to seek feedback from the industry on the proposed RTS on the requirements for the PTRR exemption under EMIR.

³ Paragraph 5 of Article 4b of EMIR requires ESMA to publish a list of PTRR service provider notified to ESMA. The link to the ESMA list can be found here: [ESMA74-1049116225-664 List of post-trade risk reduction service providers notified to ESMA for the purpose of the exemption from the clearing obligation under EMIR](#).

⁴ [Regulation - EU - 2024/791 - EN - EUR-Lex](#).

⁵ Markets in financial instruments (MiFIR) – post-reform changes on RCB, liquid markets for equity instruments, and PTRR

⁶ FR/10/2024 Final Report on Post Trade Risk Reduction Services: Sound Practices for Consideration

⁷ <https://www.fca.org.uk/publication/policy/ps25-2.pdf>.

⁸ <https://www.fca.org.uk/publication/consultation/cp24-14.pdf>.

14. In addition, the CP makes some considerations as regards the transactions to be recorded for the purposes of the exemptions under MiFIR, in order to assist the EC on the possible content of the relevant delegated act.
15. The analysis and proposal described in the CP are based on information collected on PTRR service providers and users during the ESMA PTRR services roundtable, as well as information collected on PTTR services during the PTRR services launch.
16. The CP content is also leveraging on the IOSCO Final Report on PTRRS on sound practices for consideration. To be noted that Annex III contains a table listing the practices recommended by IOSCO on PTRR services and the corresponding EU L1 and 2 provisions applicable to PTRR services, including the draft RTs.

3 Legal framework

3.1 PTRR services in EMIR

3.1.1 Compression as regards risk mitigation techniques and reporting under EMIR

17. Before the introduction of the PTRR exemption by EMIR 3, no provision in EMIR L1 addressed PTRR services (apart from a mandate for an ESMA report which led to the ESMA 2020 PTRR services Report). However, some EMIR L2 provisions, adopted before the reform, make references to such services.
18. In particular, Article 14 of the CDR 149/2023, which specifies the risk mitigation techniques under Article 11 of EMIR, requires financial counterparties and non-financial counterparties with 500 or more OTC derivative contracts outstanding with a counterparty which are not centrally cleared to regularly analyse the possibility to conduct a portfolio compression exercise in order to reduce their counterparty credit risk.
19. Furthermore, Article 7 of CDR on EMIR Reporting, which specifies the reporting obligations for counterparties and CCPs with respect to derivative contracts pursuant to Article 9(1) and (3) of EMIR, requires reporting entities to distinguish whether the conclusion or termination of contracts derives from a PTTR exercise, to assign an identifier to the PTRR exercise and link all reports originating from the same PTRR exercise.
20. To this end, Table 2 in the Annex of CDR on EMIR Reporting requires to indicate whether the contract derives from a PTTRS (field 38) and which type of PTTRS was used (field 39). The same field describes the types of exercises as follows.

FIGURE 1: FIELD 39 TABLE 2 OF CDR ON EMIR REPORTING

Field	Details to be reported
Types of PTRR techniques	<p>Indicator of a type of a PTRR operation for the purpose of reporting under Regulation (EU) No 648/2012.</p> <p>Portfolio Compression without a third-party service provider: An arrangement to reduce risk in existing portfolios of trades using non-price forming trades mainly to reduce notional amount outstanding, the number of transactions or otherwise harmonise the terms, by wholly or partially terminating trades and commonly to replacing the terminated derivatives with new replacement trades.</p> <p>Portfolio Compression with a third-party service provider or CCP: A PTRR service provided by a service provider or CCP to reduce risk in existing portfolios of trades using non-price forming trades mainly to reduce notional amount outstanding, the number of transactions or otherwise harmonise the terms, by wholly or partially terminating trades and commonly to replacing the terminated derivatives with new replacement trades.</p> <p>Portfolio Rebalancing/Margin management: A PTRR service provided by a service provider to reduce risk in an existing portfolio of trades by adding new non-price forming trades and where no existing trades in the portfolio are terminated or replaced and the notional is increased rather than decreased.</p> <p>Other Portfolio PTRR services: A PTRR service provided by a service provider to reduce risk in existing portfolios of trades using non-price forming trades and where such service does not qualify as Portfolio Compression or Portfolio Rebalancing.</p>

21. Data to be reported also includes the LEI identifying the PTRR service provider (field 40).

3.1.2 The PTRR exemption introduced by EMIR 3

Requirements

22. Consistently with what was highlighted by ESMA in the 2020 PTRR Report, Recital (10) of EMIR 3 identifies the rationale for the PTRR exemption in the benefits that PTRR services can bring to the resilience of the OTC derivative market by reducing risk⁹.
23. Article 4b of EMIR which introduces the PTRR exemption regime, sets out requirements for the PTRR exercise and for the PTRR service providers for the purposes of such exemption.
24. Paragraph 3 of Article 4b of EMIR identifies the following requirements for a PTRR exercise to be exempted from the CO:
- a) be performed by entities authorised as investment firms and independent of the counterparties to the OTC derivative contracts,
 - b) achieve a reduction in risk in each of the portfolios submitted to the PTRR exercise,
 - c) be accepted in full,
 - d) be open for participation only to entities which initially submitted the portfolio to the PTRR exercise,
 - e) be market risk neutral,
 - f) not contribute to price formation,
 - g) take the form of compression, rebalancing or optimisation or combination thereof, and
 - h) be executed on a bilateral or multilateral basis.
25. With the same objective, paragraph 4 of the same Article requires a PTRR service provider with respect to the exercise to:
- a) comply with pre-agreed rules of the PTRR exercise and act in a reasonable, transparent and non-discriminatory manner,

⁹ Recital 10 reads as follows "Post-trade risk reduction (PTRR) services reduce risks, such as credit risk and operational risk, of derivatives portfolios and are therefore a valuable tool for improving the resilience of the OTC derivatives market. They include services such as portfolio compression, portfolio optimisation and rebalancing services. PTRR service providers often use complex financial instruments to ensure that the transactions resulting from PTRR exercises are not subject to the clearing obligation. Doing so limits the usability and accessibility of PTRR services to advanced financial markets participants and reduces the benefits resulting from the use of PTRR services, as the use of complex products that are not subject to the clearing obligation increases risk in the financial system. Given the benefits of PTRR services, their use should be facilitated and made available to a wider group of market participants. Therefore, transactions resulting from PTRR services should be exempted from the clearing obligation. At the same time, to ensure the safe and efficient use of PTRR services, the exemption should be subject to appropriate conditions which are to be further specified and complemented by ESMA".

- b) ensure that entities participating in a PTRR exercise have no influence over the result of the PTRR service, and
 - c) undertake regular compression exercises where PTRR exercises result in new PTRR transactions.
26. In addition, point (d) of that paragraph 4 provides for a record keeping obligation for the provider, which requires to keep complete and accurate records of all transactions executed pursuant to PTRR exercises. Such records shall include the information on transactions entered into as part of the PTRR exercise, the transactions resulting from the PTRR exercise either as modified transactions or as new transactions and the overall change in the risk of the different portfolios included in the PTRR exercise.
27. Point (e) requires the provider to make available upon request, without undue delay, such records to the relevant competent authority and to ESMA.
28. Lastly, point (f) requires the provider to monitor the transactions resulting from the PTRR exercise in order to ensure, to the extent possible, that the PTRR exercise does not result in any misuse or circumvention of the clearing obligation.
29. Paragraph 6 mandates ESMA to further specify and complement the conditions for the PTRR exemption.

The notification process

30. Paragraph 5 of Article 4b of EMIR requires the competent authority who has authorised the PTRR service provider as an investment firm to notify the name of the PTRR service provider to ESMA and share with ESMA its assessments on how the requirements to benefit from the exemption are met. The use of the exemption is subject to such communication to ESMA by the competent authority.
31. The same provision requires ESMA, on a yearly basis, to publish the list of the notified PTRR service providers.
32. Competent authorities shall, on a yearly basis, confirm to ESMA whether the PTRR service providers continue to comply with the requirements for the exemption and duly notify ESMA where a PTRR service provider no longer complies. In such case, ESMA will remove the provider from the list of PTRR service providers.

33. Upon the launch of the new EMIR 3 regime for PTRR services, following the assessment and notification of PTRR service providers by their competent authorities in the first half of 2025, ESMA published the list of PTRR service providers¹⁰.

3.2 PTRR services in MiFIR

Exemptions under MiFIR

34. Before the MiFIR Review, MiFIR Article 31 provided an exemption for transactions resulting from compression from the trading obligation, the transparency requirements and the best execution verification¹¹.

35. The same provision required firms providing portfolio compression to make public through an APA the volume and the time of the conclusion of transactions. It also set forth a record keeping obligation, providing for the relevant records to be made available to the relevant competent authority or ESMA upon request.

36. The MiFIR Review amended Article 31 to extend the exemptions foreseen for compression to transactions deriving from all type of PTRR services.

37. The MiFIR Review also deleted the requirement to make public the volume and the time of the conclusion of transactions through an APA. On the contrary, the record keeping obligation has been maintained, but slightly amended to refer directly to EMIR. It now reads *“Investment firms and market operators that are providers of post-trade risk reduction services shall keep complete and accurate records of the transactions referred to in paragraph 1 of this Article that are not already recorded or reported in accordance with Regulation (EU) No 648/2012.”*

38. Article 2(1)(47) of MiFIR which defines portfolio compression has not been amended and remains in force.

¹⁰ Link to the ESMA list of PTRR service providers: [ESMA74-1049116225-664 List of post-trade risk reduction service providers notified to ESMA for the purpose of the exemption from the clearing obligation under EMIR.](#)

¹¹ Recital 27 of MiFIR indicates that the trading obligations “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 [EMIR] 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”.

39. The MiFIR Review does not provide a definition of PTRR services. However, Recital 35 of the MiFIR Review identifies the main features of these services. The recital also clarifies that portfolio compression is just a sub-set of PTRR services¹².
40. Under the previous regime, the Commission adopted the Commission Delegated Regulation 567/2017 (CDR 567/2017) which indicates (a) the conditions for transactions resulting from portfolio compression to be exempted from the DTO under MiFIR and (b) the information to be published through an APA¹³.
41. More in detail, Article 17 of CDR 2017/567 on the elements of portfolio compression requires a PTRR service provider to conclude a legal agreement with users, identifying when the compression becomes binding and how derivatives are terminated or replaced. Furthermore, the article details the steps of the process leading to compression.
42. Article 18 of CDR 2017/567 details the information which should be made public to ensure transparency of the compression.
43. Similarly, following the MiFIR Review, paragraph 4 of Article 31 of MiFIR empowers the Commission to adopt a delegated act to specify (a) the PTRR services for the purpose of the MiFIR exemptions, and (b) the transactions subject to the recording. To comply with the mandate as regards the specification of the PTRR services eligible for the MiFIR exemptions (point a), on 8 August 2025, the EC published for consultation a proposed delegated act ('MiFIR DA amending CDR 2017/567').
44. More in detail, the MiFIR DA amending CDR 2017/567 maintains Article 17 CDR 2017/567 on the elements on portfolio compression and considering the elimination of the publication through APA, it deletes Article 18 on the publication requirements for portfolio compression.

¹² Recital 35 of MiFIR Review reads "Post-trade risk reduction services are an essential tool of risk management with respect to OTC derivatives. Post-trade risk reduction services rely on technical transactions that are pre-arranged, non-price-forming and market-risk neutral and that achieve a reduction in the risk in each of the portfolios. Portfolio compression services, which are currently exempt from the obligation to execute orders on terms most favourable to the client as laid down in Article 27 of Directive 2014/65/EU ('best execution') and transparency requirements, are a subset of post-trade risk reduction services. In light of their technical and non-price-forming nature, the transactions on OTC derivatives that are formed and established as a result of post-trade risk reduction services should not be subject to the derivative trading obligation. Taking into account the fact that providers of post-trade risk reduction services do not allow multiple third-party buying and selling trading interests in financial instruments to interact, they should not be considered to operate a multilateral system. They should similarly be exempt from requirements of pre- and post-trade transparency and of verifying best execution. The Commission should be empowered to specify, by means of delegated acts, what constitutes post-trade risk reduction services for the purposes of Regulation (EU) No 600/2014 and the particulars of the transactions to be recorded"

¹³ https://eur-lex.europa.eu/eli/reg_del/2017/590/oj/eng.

45. In addition, paragraph 6 of Article 1 of the MiFIR DA amending CDR 2017/567 introduces in the CDR 2017/567 a new Article 16(a) to identify the conditions for PTRR services for the purposes of the MiFIR exemptions.
46. In particular, the new Article 16a of CDR 2017/567 indicates that for the purposes of the MiFIR exemptions, PTRR services are services that “*meet the following conditions:*”
- a) they are provided by a third-party service provider on the basis of non-discretionary rules that are set in advance;
 - b) the post-trade risk reduction exercise is accepted in full and, as a result, the participants in that exercise are not able to choose which trades to execute under the post-trade risk reduction exercise;
 - c) they have the purpose of achieving a reduction of risk in each derivatives portfolio submitted to the post-trade risk reduction exercise by the counterparties to the derivative transactions;
 - d) they are market-risk neutral, within the tolerances set by the counterparties to the derivative transactions submitted to the post-trade risk reduction exercise;
 - e) transactions that result from a post-trade risk reduction exercise do not contribute to price formation.”
47. Article 16a(2) of CDR 2017/567 further specifies that for the purpose of the MiFIR exemptions “post-trade risk reduction services shall include compression services, rebalancing services, and basis risk optimisation services”.
48. For completeness, pursuant to point (f) of Article 2(5) of CDR 2017/590¹⁴ transactions resulting from compression are not part of the transactions subject to transaction reporting required by Article 26 of MiFIR.

FIGURE 1: SUMMARY OF MAIN PROVISION APPLICABLE TO PTRR SERVICES

	EMIR	MIFID/MIFIR
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¹⁴ https://eur-lex.europa.eu/eli/reg_del/2017/590/oj/eng.

Exemptions	CO	DTO, Transparency and Best Execution
Record keeping for PTRR service providers	Information on transactions entered into as part of the PTRR exercise, the transactions resulting from the PTRR exercise either as modified transactions or as new transactions and the overall change in the risk of the different portfolios included in the PTRR exercise	Only for transactions not already recorded or reported according to EMIR
Reporting for users	Obligations set forth in the CDR on EMIR Reporting	N/A
L2	ESMA - RTS on requirements for the PTRR Exemption	MiFIR DA amending CDR 2017/567 specifying the PTRR services eligible for the MiFIR exemptions DA for the transactions subject to the record keeping obligation

4 RTS on the requirements for the PTRR exemption

4.1 ESMA's mandate

Background

Article 4b(6) of EMIR:

ESMA shall develop draft regulatory technical standards to further specify the elements and requirements set out in paragraphs 3 and 4 and the following other conditions or characteristics of PTRR exercises:

- (a) what constitutes market risk neutrality in a PTRR exercise;
- (b) the required risk reduction in submitted portfolios;

(c) the possible inclusion of mixed portfolios containing both cleared and uncleared transactions in the same PTRR exercise and the conditions under which such inclusion would be allowed;

(d) requirements regarding the management of the PTRR exercise;

(e) requirements for different types of PTRR services;

(f) the process for monitoring the application of the exemption granted; and

(g) the criteria to apply when assessing whether the clearing obligation is circumvented.

ESMA shall submit the draft regulatory technical standards referred to in the first subparagraph to the Commission by 25 December 2025.

49. The reference to paragraph 3 and 4 of Article 4b of EMIR in the mandate requires ESMA to specify requirements applicable to the PTRR exercise and the PTRR service provider, respectively. In addition, points a) to g) of the mandate require ESMA to elaborate in the draft RTS other conditions and characteristics regarding PTRR services, such as the monitoring of the application of the PTRR exemption.

50. As communicated to the EC in March 2025¹⁵, in light of resource constraints and significant new mandates, ESMA postponed the work on the draft RTS on the PTRR exemption to 2026.

Analysis and way forward

51. ESMA notes that the draft RTS aim is to specify the requirements set forth in EMIR, to prevent the risks arising from the PTRR exemption use, and in particular the circumvention of the CO. At the same time, ESMA pursues the objectives of simplification and burden reduction in the EU regulations (SBR).

52. On this basis, ESMA designed the proposed RTS with the objective to ensure that the requirements for the PTRR exemption are met, while limiting the potential regulatory burden for market participants.

53. To this end, the draft RTS take into consideration the best practices suggested by IOSCO for the services (see Annex III), the provisions already applicable to PTRR service

¹⁵https://www.esma.europa.eu/sites/default/files/2025-03/ESMA22-50751485-1598_Letter_from_Chair_on_prioritisation_2025.pdf

providers and users under MiFID, MiFIR and EMIR, as well as the current practices in the market.

54. For example, the proposal for the draft RTS considers that pursuant to EMIR the PTRR service providers need to be MiFID authorised firms, and thus it avoids additional requirements when the applicable MiFID provisions are sufficient to ensure compliance with the EMIR requirements for the purposes of the PTRR exemption (e.g. conflicts of interest).
55. Furthermore, with the SBR objectives in mind, the draft RTS leverages and mandates some of the current market practices, to take into consideration the experience of the industry with certain safeguards around the use of PTRR services, thus minimising potential regulatory implementation costs.
56. As the mandate is very detailed, the analysis of different aspects is combined where possible to make the CP cohesive.

4.2 Identification of PTRR Services

4.2.1 General characteristics of PTRR services

Background

57. EMIR does not provide a general definition of PTRR services. However, EMIR identifies directly the type of PTRR services that can benefit from the PTRR exemption. In this respect, point g) of paragraph 3 of Article 4b of EMIR indicates that for the purpose of the PTRR exemption, a PTRR exercise shall “*take the form of a compression, rebalancing or optimisation exercise or a combination thereof*”.
58. Before analysing the requirements for the different types of PTRR services which can benefit from the exemption, ESMA sees merit in describing the distinctive features common to all PTRR services to distinguish them from other financial services. Such description needs to be principles-based and flexible to allow for developments of PTRR services over time.
59. To this end, it is useful to consider different sources, noting however that only the EMIR provisions contained in Article 4b of EMIR are mandatory for the purpose of the PTRR exemption under EMIR.
60. Firstly, Recital 35 of the MiFIR Review indicates that PTRR services reduce risk in each of the portfolios part of the exercise while being non-price-forming, and market-risk neutral.

61. IOSCO's identification of the main features of PTRR services adds that the PTRR exercises are performed by third parties with the use of an algorithm and on an "all or nothing" basis.
62. EMIR in Article 4b lists such features (performed by third parties with the use of an algorithm and on an all or nothing basis) among the requirements for the service to be eligible for the exemption.
63. Similarly, the CDR on EMIR Reporting lists among the main features of each type of PTRR services the reduction of risk through non-price forming transactions. The CDR on EMIR Reporting however distinguishes between compression without and with a third-party service provider, admitting among PTRR exercises those not provided by a third party.
64. Lastly, the new Article 16a of CDR 2017/567 introduced by the DA amending CDR 2017/567 indicates that for the purposes of the MiFIR exemptions, PTRR services are services that are provided by a third-party service provider to achieve risk reduction, on the basis of non-discretionary rules that are set in advance; on an "all or nothing" basis, and which maintain market risk neutrality and produce non-price forming transactions.

Analysis and proposal

65. ESMA notes that MiFIR, EMIR, the DA amending CDR 2017/567, and the IOSCO PTRR service Report consistently identify some common distinctive features for PTRR services; namely risk reduction through market risk neutral and non-price forming transactions.
66. Similarly, the performance of the exercise by a third party through the use of an algorithm on an "all or nothing" basis is recognised as a characteristic of PTRR services by EMIR, IOSCO, and the DA amending CDR 2017/567.
67. The CDR on EMIR Reporting does not include the provision of the service by a third party among the identifying elements of PTRR services and thus lists compression without a third party among PTRR services. However, such difference seems justified by the reporting objective of CDR on EMIR Reporting, which requires to include a broader scope of transactions than the one covered by the CO exemption.
68. In light of the above, ESMA understands that PTRR services aim to achieve a reduction of the risk on each of the derivatives portfolios subject to the exercise, by using transactions that do not contribute to price formation and that are market-risk neutral. They are provided by a third party through the use of an algorithm and on an all or nothing basis.

4.2.2 Requirements for different types of PTRR services

69. The three main types of PTRR services commonly used in the market include compression, portfolio rebalancing and basis risk optimisation.
70. Consistently, Recital 10 of EMIR 3 indicates PTRR services “include services such as portfolio compression, portfolio optimisation and rebalancing services”.
71. Point (g) of paragraph 3 of Article 4b of EMIR requires for the purpose of the exemption the service to take the form of “*compression, rebalancing or optimisation exercise or a combination thereof*”.
72. The DA amending CDR 2017/567 identifies the same type of PTRR exercises as eligible for the purposes of the MiFIR exemptions.
73. ESMA notes that the same type of services can sometimes be referred to with diverging terminology (e.g. rebalancing is sometimes called counterparty optimisation, optimisation sometimes refers to a combination of rebalancing and compression).
74. Point e of the mandate requires ESMA to specify the requirements for the different types of PTRR services.
75. To this end, ESMA sees merit in describing the characteristics of the main PTRR services in use today, taking into consideration the applicable provisions.

4.2.2.1 Compression

Background

76. Starting with compression, Article 2(47) of MiFIR indicates that “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”.
77. As the definition of compression in MiFIR has not been amended, it continues to apply under the new regime.
78. Similarly, the definition of “compression with a third-party service provider or a CCP” in the CDR on EMIR Reporting refers to an exercise reducing the notional amount, the number of transactions or “*otherwise harmonise the terms, by wholly or partially terminating trades and commonly to replacing the terminated derivatives*”.

79. By reducing the number of trades by replacing, terminating or amending duplicative transactions compression reduces the operational and counterparty risk and cost.
80. Compression can be performed bilaterally or multilaterally.
81. In the 2020 PTRR service Report, ESMA also distinguished between *riskless compression* and *risk constrained* compression.
82. In riskless compression, trades are terminated in full or in part and full market risk neutrality is achieved. Contrastingly, in case of risk constrained compression when it is not possible to find perfectly matching transactions to terminate trades, nearly matching transactions can be used to replace the original ones, and risk tolerances are applied for this purpose. As a result, the original risk profile of the party is still broadly maintained even through the replacement of old transactions with slightly different transactions in relation to e.g. maturity dates, rates or coupons.

Analysis and Proposal

83. ESMA considers that the MiFIR definition identifies adequately for the purposes of the PTRR exemption the main features of compression. Such features are 1) the reduction of the notional amount in a portfolio through 2) the replacement or termination of transactions.
84. Thus, ESMA proposes to identify the requirements of compression in the draft RTS taking into consideration the features and the objectives described in the compression definition enshrined in Article 2(47) of MiFIR.

4.2.2.2 Portfolio Rebalancing and its possible combination

Background

85. The CDR on EMIR Reporting identifies portfolio rebalancing as follows: “A PTRR service provided by a service provider to reduce risk in an existing portfolio of trades by adding new non-price forming trades and where no existing trades in the portfolio are terminated or replaced and the notional is increased rather than decreased”.
86. Portfolio rebalancing (sometimes also called counterparty risk optimisation, or optimisation) generates additional offsetting trades among different participants to reduce the outstanding counterparty risk exposure on a net basis (although the number of trades is increased, the net risk is reduced thanks to the rebalancing of risk and the associated offsetting trades).
87. As a result, the credit risk exposure between counterparties is reduced, whereas the overall market risk remains unchanged.

88. Portfolio rebalancing is run on a multilateral basis and risk tolerances are set for the purpose of the exercise.
89. Lastly, it is worth noting that in some cases rebalancing is combined with compression, where on top of the addition of trades, some trades are then terminated to achieve the desired risk reduction, including in terms of notional and number of trades.

Analysis and Proposal

90. ESMA considers that the CDR on EMIR Reporting identifies adequately for the purposes of the EMIR PTRR exemption the main features of portfolio rebalancing. Such features are 1) the increase of the notional amount in a portfolio through 2) the addition of offsetting transactions adequately.
91. Thus, ESMA proposes to identify the requirements of portfolio rebalancing in the draft RTS taking into consideration the features and the objectives described for portfolio rebalancing in CDR on EMIR Reporting.
92. For the combination of rebalancing with compression see section 4.2.2.4 on “other services”.

4.2.2.3 Basis risk optimisation

Background

93. No definition is provided under the EU regulation of basis risk optimisation.
94. The industry identifies basis risk optimisation as a service which reduces basis risk in hedged portfolios. This service’s objective is to reduce the mismatched exposure arising from imperfect correlation between the hedging instruments and the hedged instruments. Many instruments used for hedging, such as interest-rate swaps, imply periodic payments and change of exposure over time, which is why misalignments may accumulate over time. Basis risk optimisation reduces the risk that derives, for example, from the accumulation of misaligned fixing dates or expiry dates (fixing risk), by introducing non-price forming trades; furthermore, as a result of a basis risk optimisation, no existing trade in the portfolio is terminated or replaced and the gross outstanding notional of the submitted portfolio is increased rather than decreased.
95. Similarly to portfolio compression and portfolio rebalancing, this service reduces second order risk e.g., in this case, the residual basis/fixing mismatches in an hedged portfolio, without changing the overall market risk of the portfolio.

96. It is worth noting that by adding transactions (potentially also with new counterparties) basis risk optimisation may introduce new counterparty risk. Such feature of basis risk optimisation raised doubts in the past on the qualification of this type of service as a PTRR service for the purpose of the PTRR exemption¹⁶.

97. As discussed further down, ESMA believes that the feature of basis risk optimisation to increase a specific type of risk (e.g. counterparty risk) does not hinder its qualification as an eligible PTRR service. This is because the increase of a specific type of risk does not constitute an obstacle to the achievement of an overall risk reduction in the portfolios submitted to the PTRR exercise (see section 4.3.2). As a result, where the risk reduction required under EMIR is interpreted as reduction of the overall risk, and basis risk optimisation exercise meets such requirement, it can be qualified as an eligible PTRR service.

98. In addition, it is worth noting that basis risk optimisation shares with compression and portfolio rebalancing the main features of PTRR services, and, as these two types of PTRR services, occurs in cycles in which more than one participant takes part.

Analysis and Proposal

99. ESMA would propose identifying, in the draft RTS, basis risk optimisation as a PTRR service that reduces basis risk in hedged portfolios by introducing non-price forming trades and in which no existing trade in the portfolio is terminated or replaced and the notional is increased rather than decreased.

4.2.2.4 Other PTRR services

Background

100. Despite EMIR 3 recognising as eligible services only compression, portfolio rebalancing and basis risk optimisation, or a combination thereof, ESMA sees merits in investigating and reaching a common understanding on what could be “other PTRR services”, given future possible development of the services.

101. In this respect, the CDR on EMIR Reporting identifies as “Other Portfolio PTRR services” services which present the characteristic features of PTRR services and do not

¹⁶ In ESMA 2020 PTRR service Report, section 4.11 “Other PTRR Services” reads “is reported that one response to the consultation noted that basis risk reduction services would not naturally fall within PTRR services as this type of PTRR service does not address bilateral counterparty risk, and as such is not negatively impacted by the current clearing obligation”.

qualify as the other services described above (notably compression or portfolio rebalancing).

Analysis

102. Consistently, ESMA proposes to consider compression, rebalancing and possibly basis risk optimisation, as examples of PTRR services, but to not exclude other portfolio PTRR services which may be developed.

103. In this respect, ESMA notes that other types of PTRR services may include any other services falling under the description provided (see section 4.2.1), but which do not qualify as compression, portfolio rebalancing, basis risk optimisation or a combination thereof.

104. So far, ESMA is not aware of other types of PTRR services, and respondents to the consultation are thus invited to indicate if other types may exist. In addition, the PTRR services offer is expected to continue evolving. Therefore, new types may also come to the market over time and ESMA stands ready to consider these new types of PTRR services in the future.

FIGURE 2: MAIN FEATURES OF THE DIFFERENT TYPE OF PTRR SERVICES

	Compression	Portfolio Rebalancing	Basis risk optimisation
Objective	Reduces number of transactions	Generates new off-setting transactions	Adds equal and opposite technical transactions to neutralise the second order fixing risk in hedged portfolios
Notional	Reduced	Increased	Increased
Risk reduced	Operational and counterparty risk	Counterparty risk	Fixing risk and basis risk

Q1: Do you agree with the description and analysis of PTRR services, portfolio compression, portfolio rebalancing, and basis risk optimisation? If not, why?

Q2: Do you know other types of PTRR services? Please elaborate.

4.3 The PTRR exercise

4.3.1 Market risk neutrality

Background

105. Market risk neutrality refers to the ability of amended, new and terminated transactions to collectively not affect the exposure of the portfolio to market movements. Consistently, a 'market risk neutral' exercise is an exercise where the pre- and post- exercise market risk sensitivities (e.g. delta, etc) remain the same, or broadly the same within small tolerances.
106. In the specific context of PTRR services, by market risk neutrality the industry refers to the fact that the transactions used to perform the PTRR exercise aim to leave unchanged the market risk of the portfolios subject to the exercise, or broadly unchanged when within limited tolerances.
107. Limited tolerances are necessary as PTRR services may deliver solutions that are not completely market risk neutral. For example, in compression, when it is not possible to use perfectly matching transactions to terminate trades, nearly matching transactions may be used to replace the original ones, resulting in small risk increases or decreases.
108. In the current practice, to maintain market risk neutrality at a satisfactory level, tolerances for risk, and in particular limits for market risk, are set by participants when submitting their portfolio to the provider for the exercise.
109. The risk tolerances are then applied by the algorithm to identify the transactions to be torn up or netted down, in the case of *compression*, or the off-setting trades to be added to the portfolio in the case of *rebalancing*.
110. Similarly, in *basis risk optimisation*, the user sets tolerances to ensure that the new administrative transactions used to neutralize the second order fixing risk of original positions, do not change the overall market risk of the portfolio.
111. Lastly, controls at the end of the exercise ensure that the original market risk profile of the portfolio is maintained.
112. The practice to set tolerances has been recognised and recommended by the IOSCO PTRR services Report, which, regarding "Transparency, governance, comprehensibility and fairness of the algorithm", recommends that "*Users should aim to ensure the resulting*

trades from PTRRS remain market-risk neutral within the tolerances set by the users and the output of the algorithm should be validated against a series of embedded checks.”

113. With respect to compression, Article 17 of CDR 2017/567 already requires providers to require participants to specify their risk tolerances including a limit for market risk, counterparty risk and cash payment tolerances for the purpose of the MiFIR exemption.

114. Article 4b(4) of EMIR includes among the records to be kept by the provider under point “iii” “the overall change in the risk of the different portfolios included in the PTRR exercise”.

Analysis and proposal

What constitutes market risk neutrality in a PTRR exercise

115. ESMA proposes for the draft RTS to clarify that the concept of market risk neutrality in a PTRR exercise equals to no change or close to no change, when within reasonable tolerances, in the market risk of each portfolio before and after the exercise.

116. Furthermore, ESMA notes that currently variations of market risk within small tolerances are considered market risk neutral, but there is no hard threshold (e.g. a specific figure) to limit the maximum tolerances for this purpose. On the contrary, tolerances for market neutrality may depend on the portfolio subject to the exercise and the limits set by participants to the PTRR exercise.

117. To collect more information on the thresholds, ESMA invites market participants to indicate how tolerances are currently set in a PTRR exercise and asks their opinion on whether some criteria could be set to define appropriate risk tolerances to ensure market neutrality.

Requirements for the PTRR exercise to be market risk neutral

118. With respect to the specification of the requirements for the exercise to be market risk neutral, ESMA proposes to require the PTRR service providers to limit the application of tolerances by users within a range which broadly ensures market risk neutrality, and thus reject any excessive tolerances set by users which does not meet market risk neutrality.

119. Furthermore, to enhance compliance with the requirement ESMA proposes to:

- require the PTRR service providers to design and set the rules, including the methodologies and the algorithm used in pre-scheduled cycle in a way that the PTRR exercise achieves market risk neutrality (see section 4.4.1);

- mandate for all type of PTRR services the use of tolerances, as already required for compression by Article 17 of CDR 2017/563 (see section 4.4.3);
- require PTRR service providers to check that the proposal resulting from the application of the rules, methodologies and algorithms in each exercise complies with the requirements on market risk neutrality (see section 4.4.1).

120. Furthermore, to facilitate checks by the competent authorities on the market risk neutrality of the PTRR exercise, ESMA proposes for the PTRR service provider to include in the records displaying “the overall change in the risk of the different portfolios”, mandated by Article 4b paragraph 4 of EMIR, information displaying that the result of the PTRR exercise is market risk neutral (see also section 4.4.6).

Q3: Do you agree with ESMA proposal on market risk neutrality? If not, why?

Q4: Can you please provide information on how are tolerances usually set in a PTRR exercise, and what is their level, if possible? Do you think some criteria should be set to identify appropriate risk tolerances to ensure market risk neutrality of PTRR exercises?

4.3.2 Risk reduction

Background

121. The different types of PTRR services aim to reduce different types of secondary risks: compression reduces operational risks, rebalancing counterparty risk, and basis risk optimisations targets fixing and basis risk, while leaving primary risk unchanged.
122. The reduction of the secondary risks also aims to lower the initial margin requirements of the counterparties, freeing capital use and enhancing liquidity. This feature is characteristic of all the types of services mentioned. The ability of PTRR services to reduce risk, while improving capital use and liquidity, qualifies them as a valuable tool for enhancing the resilience of the OTC derivatives market.
123. Market participants have indicated that risk reduction is inherent to PTRR services, given that the success and the attractiveness of the PTRR services rely on their ability to reduce risk. Thus, the rules, methodologies and algorithms applied in the PTRR exercises (also collectively referred to as the ‘Algorithm’) are designed to reduce risk to the maximum possible extent.
124. However, it is worth noting that the changes brought to the portfolio may increase certain types of risks, despite reducing the risk inherent to the portfolio overall.

125. For example, as highlighted by IOSCO, as a result of a portfolio rebalancing run a market participant may reduce its risk to its counterparties overall (lowering initial margin requirements), while at the same time potentially increase its exposure to one counterparty or introduce a new exposure¹⁷.
126. Similarly, basis risk optimisation by adding transactions (potentially also with new counterparties) may introduce new counterparty risk¹⁸.
127. The way that the PTRR exercises are currently conducted in practice permits participants to submit to the PTRR exercise their preferred risk tolerances, according to their own risk management. In addition, participants to a PTRR exercise can refuse to adhere to a run in case they are not satisfied in terms of risk reduction with the proposal made by the algorithm
128. In particular, market participants reported that the performance of PTRR exercises, in the case of portfolio rebalancing or basis risk optimisation alike, follow the same steps mandated for compression by Article 17 of CDR 2017/567.
129. More in details, consistently with the process required for compression by Article 17 of CDR 2017/567¹⁹, PTRR service providers at the beginning of each PTRR exercises, collect data from participating firms regarding their portfolios, risk tolerances for each type of risk, and targeted initial margin savings.
130. To avoid results that would not be acceptable regarding counterparty risk, participants before the run can indicate their preferred overall maximum exposure per counterparty and the name of an acceptable or unacceptable counterparty. As for each run, the parameters are re-set, they can change over time.
131. Using the data submitted by the participant to the PTRR exercise, the Algorithm elaborates a proposal (the “Exercise Proposal” used to perform a dry run). The Exercise Proposal is submitted to clients who can decide whether to accept it or not. Only in case of

¹⁷ IOSCO PTRRS Report change in counterparty risk pg 25-25. On the same point, IOSCO notes the risk of increasing counterparty risk is exacerbated in a financial system consisting of a few major market participants and many smaller market participants, where, notional exposures between smaller market participants are low and notional exposures between major market participants are high due partly to the relatively higher credit quality, product offering, and repayment capacity of larger market participants. In such a case, risk redistribution occurs without consideration of any external factors (e.g., size, credit quality), the post-redistribution notional exposure may result in larger notional exposures between minor market participants and relatively smaller notional exposures between major market participants. As a result “All else held equal, counterparty risk redistribution that ignores external factors may result in larger counterparty exposures to relatively higher-risk counterparties, ultimately resulting in higher counterparty risk”.

¹⁸ On the qualification of basis risk optimisation as a PTRR service for the purpose of the PTRR exemption see section 5.2.4.

¹⁹ As indicated in section 4.2, Article 17 of CDR 2017/567 makes mandatory in the case of compressions for PTRR service providers to require participants to specify their risk tolerances (including a limit for market risk, counterparty risk and cash payment tolerances), and to receive the acceptance of the proposal by users before the run for the purpose of the MiFIR exemption

acceptance, the transactions proposed by the algorithm are executed. After every run, participants receive a performance report with the exercise results (the “Exercise Performance Report”).

Analysis and proposal

The required risk reduction in submitted portfolios

132. As a general remark, ESMA points out that pursuant to paragraph 3 of Article 4b of EMIR for the purpose of the PTRR exemption, risk reduction needs to be achieved in each of the portfolios submitted to the PTRR exercise. Thus, the criteria that are set forth in the draft RTS regarding risk reduction need to apply to all the participants to a PTRR exercise. Consistently, where only some of the portfolios submitted to the PTRR exercise benefit from the risk reduction as specified in the draft RTS, the PTRR exemption cannot be applied.
133. ESMA also understands that an increase in a specific type of risk or an increase of risk toward a specific counterparty does not hinder a reduction in the overall risk of the portfolios submitted to the PTRR exercise. However, an increase in a specific type of risk (including risk towards a specific counterparty) may be considered as acceptable only as far as (i) the overall risk is reduced and (ii) such increase is within the tolerances set by the participants to the PTRR exercise.
134. Consistently, the draft RTS proposes for the PTRR exercise to benefit from the PTRR exemption only where the increase in certain risk factor contributing to the overall risk, such as operational risk, or counterparty risk, is within the tolerances set by the participants in each exercise, and provided that the overall risk is reduced.

Requirements for the exercise to achieve a reduction in risk in each of the portfolios submitted to the PTRR exercise

135. To ensure that the outcome of the exercise is in line with the risk management procedures of participants, the draft RTS in the Chapter regarding the requirements for the PTRR service provider require to apply the procedure and the steps set forth in Article 17 of CDR 2017/563 for compression to all type of PTRR exercises (see draft RTs, Chapter III on the operating conditions for the PTRR service providers).
136. In particular, the draft RTS provide for the PTRR service provider to require participants to set their tolerances level, and to make a proposal aligned with such tolerances. Furthermore, the run is subject to the acceptance of the proposal by the participants, to permit participants to drop out where they are not satisfied with the proposed risk reduction.

137. In addition to what is currently mandated for compression, the draft RTS specify that participants to the PTRR exercise may exclude certain counterparties for the transactions to be added to their portfolios when specifying their risk tolerances.
138. Furthermore, the draft RTS further detail the content of the Exercise Proposal (in comparison to what is currently mandated for compression under Article 17 of CDR 2017/563²⁰), in order for the Exercise Proposal to display how the different risks are reduced (e.g. the exposure per counterparty highlighting any relevant increase).
139. Furthermore, it is proposed that the Exercise Proposal includes the information that is necessary to check the consistency between the risk tolerances submitted to the providers and the proposed outcome of the exercise (see section 4.4.3).
140. In addition, the draft RTS require the PTRR service providers to set the rules, methods and algorithms used in pre-scheduled cycle in order for the PTRR exercise to respect the risk tolerances set by participants and achieve risk reduction, as detailed in the draft RTS (see section 4.4.1). The draft RTS also details the governance control and procedures of the PTRR service providers to ensure compliance with the risk reduction requirement (see section 4.4.2).
141. Lastly, the draft RTS proposal regarding the record to be kept by the PTRR provider specify the content of the records as regards “the overall change in the risk of the different portfolios included in the PTRR exercise”, to facilitate the checks on the compliance of the PTRR exercise with the requirements on risk reduction as set forth in the draft RTS (see section 4.4.6).

Q5: Do you agree with ESMA analysis and proposal on risk reduction by PTRR services? Do you think any additional criteria should be used to determine risk reduction in PTRR services?

4.3.3 Non-price forming transactions

Background

142. Non-price forming transactions are transactions that do not contribute to the price discovery process, because they are not executed at market prices or because they do not reflect the buying/selling interests of parties based on market movements.

²⁰ Article 17 of CDR 2017/567 requires the proposal to focus on the identification of the counterparties, the changes to the notional value and the variation of the combined notional amount to the risk tolerances specified.

143. Recital 27 of MiFIR acknowledges transactions resulting from PTRR services are not price forming. Consistently, Article 31 of MiFIR in its previous version provided an exemption for compression from transparency requirements, and the MiFIR Review enlarged this exemption to all PTRR services.
144. Market participants pointed out that the PTRR exercises are generally run either intraday over multiple hours or overnight. As a result, the transactions are recorded away from market prices and hence do not contribute to price formation.
145. More generally, market participants unanimously qualify transactions resulting from PTRR services as administrative transactions, as opposed to trading or price-forming transactions.

Analysis and proposal

146. ESMA notes different features of PTRR services qualify the transactions resulting from a PTRR exercise as non-price forming.
147. Firstly, the objective of a PTRR exercise is risk reduction, as opposed to reflecting the buying and selling interests of the parties according to market movements. The risk reduction objective of the PTRR exercises is mandated by point b of paragraph 3 of Article 4b of EMIR.
148. Secondly, the PTRR exercise is market risk neutral, as required by point e) Article 4b(3) of EMIR; consistently, the transactions resulting from the PTRR exercise cannot increase the market risk in participants' portfolios.
149. Thirdly, the transactions in a PTRR exercise are not concluded on the basis of bids or offers or negotiations but according to pre-defined rules. In this respect, point a of Article 4b(4) of EMIR requires the providers when performing a PTRR exercise to "*comply with pre-agreed rules [...] including methods and algorithms in prescheduled cycles*".
150. As the mentioned requirements sets forth by EMIR 3 already ensure the transactions added in a PTRR exercise are non-price forming, ESMA would not see any need to further specify the non-price forming requirement in the RTS.

4.3.4 Possible inclusion of mixed portfolios and circumvention of the CO

151. Background
152. One of the risks identified by the legislator to the use of the PTRR for the exemption to the CO is the possibility to use PTRR services to circumvent the CO. Such risk may arise

from the replacement of certain types of transactions with others, intrinsic to the PTRR exercise, combined with the avoidance of the CO following the PTRR exemption application.

153. This would for example be the case where transactions non-subject to the CO (e.g., certain non-standard calendars or other transactions attributes) are replaced with transactions subject to the CO (e.g. standard cleared swaps), with similar economic effect, but which would not be subject to clearing as benefitting from the PTRR service exemption from the CO.
154. In such a scenario, the risk inherent to the portfolio is moved from the non-cleared space to the cleared space without clearing occurring. As a result, the firm would maintain its exposure, while avoiding clearing.
155. It is worth noting that the example provided is a hypothetical scenario and no practice of such sort has been reported. On the contrary, different market participants, including users and CCPs, noted PTRR services are currently used for legitimate risk reduction purposes. Nevertheless, such hypothetical risk cannot be entirely discarded when designing the PTRR exemption regime.
156. To avoid circumvention of the CO, the ESMA 2020 PTRR service Report, after noting that compression on mixed portfolios could not occur within a low tolerance threshold, recommended for compression to take place only on either uncleared portfolios or cleared portfolios (as opposed to mixed portfolios)²¹.
157. On the contrary, as portfolio rebalancing can achieve good level of risk reduction even when performed on mixed portfolios, the same restriction was not recommended for rebalancing²².
158. Taking such observations into account, the mandate for the draft RTS includes a specific point on possible inclusion of mixed portfolios and relevant requirements for the exercise.
159. Market participants reported that, currently, compression is conducted either on cleared or uncleared portfolios, whereas rebalancing interests mixed portfolios. Furthermore, the PTRR exercises are generally executed on similar transactions (e.g. same asset classes) to simplify the process and its execution.

²¹ Where compression takes place on cleared transactions, as one of the parties to the exercise is a CCP, also the replacing transactions will be conducted with a CCP, so there is no need for the use of the exemption.

²² This is because the addition of trades among different parties permits more flexibility on redistribution of risk, in comparison to compression, where trades are terminated or replaced, usually within a smaller pool of parties.

Analysis and Proposal

160. ESMA firstly recalls that the CO is a safeguard to contain risk in derivative trading.
161. As the transactions deployed in a PTRR exercise do not increase the overall risk to the portfolios, but on the contrary reduce it, the exemption from the CO is justified by the circumstance that there is no additional risk to be contained through the application of the CO in a PTRR exercise.
162. It is also important to note that for the exercise to be legitimate, it is not only necessary that an overall risk reduction is achieved, but also that there is no increase in the uncleared risk, whereby uncleared risk is meant to be the risk deriving from bilateral transactions not cleared via a CCP.
163. For instance, where transactions not subject to the CO (swap options between non-CCP counterparties) are replaced with transactions that do not need to be cleared thanks to the exemption (swaps), the avoidance of the CO appears to be legitimate, as far as the replacement between transactions does not increase the net uncleared risk²³.
164. On the contrary, where the termination of transactions to be cleared is accompanied by an increase of the uncleared risk (e.g. addition of transactions among non-CCP counterparties) the risk added in the overall portfolios would not be subject to the CO because of the PTRR exemption, and the PTRR exercise may qualify a circumvention of the CO.
165. As a result, ESMA proposes to draw the line between legitimate and illegitimate use of the exemption by considering whether the exercise brought any increase in the net uncleared risk.
166. This interpretation is in line with the rationale of the recommendation in the ESMA 2020 PTRR service Report, which limited the use of compression to uncleared portfolios, to avoid that the application of wide risk tolerances – necessary to accommodate the exercise on mixed portfolios – may lead to a risk increase.
167. However, with respect to such recommendation it is worth noting that where the risk reduction is limited due to the application of wide risk tolerances, the run is unlikely to be accepted. Consistently, compression is currently performed either on cleared or uncleared portfolios to optimise risk reduction.

²³ It is also worth noting that as a second step, the counterparties in the above-mentioned example could voluntarily clear the transactions resulting from the PTRR exercise towards a CCP, where the clearing would present some advantages.

168. Furthermore, the risk reduction requirements introduced by the draft RTS may already prevent the use of wide tolerances.
169. As a result, in light of the information collected from market participants and the new requirements applicable to PTRR service providers, ESMA does not consider necessary to limit the type of portfolio which could be subject to the exercise.
170. However, as a safeguard against any circumvention of the CO, ESMA would propose for the article on risk reduction in the draft RTS to require that the PTRR exercise does not increase the aggregate net uncleared risk in the portfolio of any PTRR service participant.
171. Furthermore, ESMA proposes for the PTRR service providers to adopt specific measures and safeguard to avoid any increase in the uncleared risk of the PTRR exercises (see section 4.4.2). In addition, the draft RTS require that the records to be kept by the PTRR service providers contain the information necessary to facilitate checks on compliance with such obligation (e.g. Exercise Performance Report) (see section 4.4.6).
172. To further reflect on these observations, ESMA is interested in the view of market participants on circumvention of the CO through PTRR services, and whether they see any need for targeted safeguards (including portfolios composition) to prevent such circumvention.

Q6: Do you agree with ESMA's proposal relating to the safeguards to avoid a circumvention of the CO? Would you add specific limitations regarding the composition of the portfolios subject to the exercise (e.g. uncleared portfolios only for compression)? Please justify your answer.

4.3.5 Independence of the PTRR service provider from the counterparties to the OTC derivative contracts included in the PTRR exercise

Background

173. Point a) of paragraph 3 of Article 4b of EMIR indicates that to be eligible for the CO exemption the PTRR exercise shall “be performed by an entity authorised in accordance with Article 7 of the Directive 2014/65/EU that is independent of the counterparties to the OTC derivative contracts included in the PTRR exercise”.
174. Considerations on the independence of the PTRR service provider may be relevant where the PTRR service provider is part of the same group of one of the counterparties to the OTC derivative contracts included in the PTRR exercise (e.g. CCP) or is somehow linked to one of the counterparties (e.g. possible investment from one or more PTRR participating banks in a service provider).

175. Generally speaking, the concept of “independence” is linked to the absence of any conflicts of interest or vested interest in the service provided.
176. Under Article 4b of EMIR, to be eligible to the exemption, PTRR service providers should be MiFID authorised entities and need thus to comply with Article 23 of MiFID on conflicts of interest. Article 23 of MiFID requires investment firms to identify, prevent or manage conflicts of interest between themselves or any person directly or indirectly linked to them and their clients. The same provision requires to disclose conflicts of interest to clients when it is not possible to prevent it.
177. Furthermore, Article 34 of CDR 2017/565 details the conflict of interest policy to be kept by investment firms pursuant to MiFID.
178. Market participants reported that PTRR algorithms generate their output on the basis of the portfolios submitted, without taking into consideration the identity of the participants. As a result, the outcome of the algorithm is neutral, and it is not influenced by the participating entities.

Analysis and proposal

179. ESMA is of the view compliance with the MiFID obligations on conflicts of interest may suffice to ensure the independence of the providers to the counterparties to the OTC derivative contracts included in the PTRR exercise.
180. Furthermore, ESMA notes that the way the algorithms currently operate (i.e., considering only portfolios and not the identity of the participants) reduces the risk of conflicts of interest.
181. As a result, ESMA would rely on the obligations contained in MiFID regarding the conflict of interest to safeguard the independence of the PTRR service providers in the provision of the PTRR service.
182. However, to avoid the use of general policies which may be inadequate for the PTRR services, the draft RTS require PTRR service providers to add a specific section in their policy on conflicts of interest on PTRR services. The section in the policy on conflict of interest dedicated to the PTRR service is expected a) to describe any circumstances which constitute or may give rise to a conflict of interest impacting one or more participants in the PTRR exercise; and b) to specify the procedures to be followed and measures to be adopted in order to prevent or manage such conflicts.
183. For example, in case the PTRR service provider is part of the same group as one of the counterparties to the OTC derivative contracts included in the PTRR exercise (e.g.

CCP), the PTRR service providers should identify such circumstances as a potential conflict of interest in its policy on the conflicts of interest and describe the measures adopted in order to prevent or manage such conflicts.

184. A recital in the RTS clarifies that over reliance on the mere disclosure of conflict of interest is not adequate to manage conflict of interests and stresses the importance of the adoption of preventive measures.

185. Lastly, ESMA proposes that the PTRR service provider keep records of its conflict of interest cases, to be shared with the authority.

Q7: Do you agree with ESMA proposal on the independence of the provider from the parties to the OTC derivatives contracts included in the exercise?

4.3.6 Participation and execution of a PTRR exercise

186. Article 4b(3) of EMIR reads:

“An eligible PTRR exercise shall: [...]

c) be accepted in full, and as a result, the participants in the PTRR exercise shall not be able to choose which trades to execute under the PTRR exercise;

d) be open for participation only to entities that initially submitted a portfolio to the PTRR exercise; [...]

g) take the form of a compression, rebalancing or optimisation exercise or a combination thereof [...];

h) be executed on bilateral or multilateral basis”.

187. As previously indicated, the PTRR exercises are executed in cycles which entail pre-defined steps (i.e. submission of the portfolio, Exercise Proposal, acceptance and execution)²⁴. Some of these steps are already mandatory for compression pursuant to Article 17 of CDR 2017/567.

²⁴ More in details, firstly, PTRR service providers schedule a run and send a request to participants in order to collect data; (ii) users fill in positions, risk tolerances, including credit limits, and matching options; (iii) such data is sent back to the provider before a certain point in time (iv); providers verify data; (v) the algorithm match the positions and makes the Exercise Proposal which indicates the changes to be brought to the portfolios; (vi) the provider checks that the Exercise Proposal is line with the tolerances submitted; (vii) the Exercise Proposal is submitted to participants; (viii) participants accept the proposal and execute the transactions (ix) the PTRR service provider issues the Exercise Performance Report to participants.

188. Market participants reported that the steps currently mandated for compression are also used in practice in the other types of PTRR services, and it is not possible for participants to a PTRR exercise to execute only part of the steps in any PTRR exercise.

189. As a result, PTRR exercises are carried out in a way that allows participation only to entities that initially submitted a portfolio to the PTRR exercise.

190. In practice, the execution of PTRR exercises does not allow partial acceptance of the Exercise Proposal.

Analysis and Proposal

Participation limited to entities which initially submitted their portfolios and execution of the PTRR exercise on an all or nothing basis

191. ESMA acknowledges that the way PTRR exercises are currently performed ensures that: i) only entities which have submitted their portfolios to the PTRR exercise participate in the run; and ii) there is no risk of partial acceptance of the proposal.

192. To ensure that the provisions contained in Article 17 of CDR 2017/567, concerning the management of the exercise, continue to apply and extends to the different types of services under EMIR, ESMA intends to insert similar provisions in the draft RTS (see also section 4.4.3).

193. In addition, to ensure participants to the PTRR exercise are aware of the mode of operation of a PTRR exercise, and comply with the requirements for the purpose of the PTRR exemption, the draft RTS requires the PTRR service provider in the phase leading to the contract for the provision of the PTRR service (onboarding phase) to inform their clients about how a PTRR exercise operate and describe the PTRR exercise steps, as well as the actions required to participants in each step.

194. In particular, it is proposed that the PTRR service provider in the onboarding phase clearly points out to clients that the participation to the PTRR exercise is open only to entities that initially submitted a portfolio to the PTRR exercise, and which perform all the PTRR exercises steps.

195. In addition, the draft RTS requires to specifically inform clients that each exercise participant must either fully accept or reject the proposal, and that a partial execution of the proposed transactions is not an option.

196. In this respect, participants should also be informed that in line with the all-or-nothing principle, participants remain free to not take part in a run if the outcome is not in line with their risk reduction targets or management.

197. Information on the functioning of the PTRR exercise could be included in a document (for example a rulebook or a policy) to be shared with clients and to be referred to in the contractual agreement.
198. ESMA also notes that for the PTRR service providers to act in a transparent manner as required by paragraph 4 of Article 4b of EMIR, it would be important to inform participants, not only on the functioning of the PTRR exercise and relevant steps, but also on how the algorithm operates the PTRR exercise.

Execution on bilateral or multilateral basis

199. ESMA interprets the requirement set forth in point h) of paragraph 3 of Article 4b of EMIR for the exercise to be executed on a bilateral or multilateral basis as referring to the possibility for the run to not be only bilateral but also multilateral. In this respect, such requirement is clear and self-explanatory and does not need to be further specified.
200. In addition, it is worth recalling that all the types of PTRR exercises mandated by point g) of paragraph 3 of Article 4b of EMIR (compression, portfolio rebalancing and basis risk optimisation or a combination thereof) operate on a bilateral or multilateral basis (see section 4.2.2). As a result, the identification of the eligible types of PTRR services already implies that the execution can only be bilateral or multilateral.

Q8: Do you agree with ESMA's proposal on the information to be provided to clients?	
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4.4 Operating conditions for the PTRR service providers

4.4.1 The algorithm and the obligation to act in a reasonable, transparent and non-discriminatory manner

Background

201. Paragraph 4 of Article 4b of EMIR requires providers to “comply with the pre-agreed rules of the PTRR exercise, including methods and algorithms in prescheduled cycles, and act in a reasonable, transparent and non-discriminatory manner”.
202. ESMA remarks that for the provider to act in a reasonable, transparent and non-discriminatory manner, it would be important to specify certain requirements regarding the algorithm.

203. Market participants reported that at the time of the onboarding they do not engage in a due diligence of the algorithm but rather focus on its outcome. Furthermore, they rely on the good outcome of the algorithm (i.e. risk reduction for all participants) for its fairness²⁵ (i.e. an algorithm reducing risk for all participants is fair).

204. As indicated in the part of this CP on risk reduction, the good outcome of the algorithm determines the acceptance of the run by users, and ultimately the attractiveness of the services. If one participant does not accept the proposal, the exercise needs to be run again, without that participant (see section 4.3.2)

205. The IOSCO Report under the good practice on Transparency, governance, comprehensibility and fairness of the algorithm for users and PTRR service providers indicates that:

“As part of reasonable due diligence PTRRS users should aim to have a basic, understanding of the design of the proprietary risk reduction algorithm(s) used by the service provider. PTRRS providers should aim to ensure that, without revealing any intellectual property, there should be appropriate, high-level transparency around the algorithm used and proper controls and governance around it, including regarding the use of Artificial Intelligence (AI) and Machine Learning (ML). Users should aim to ensure that the overall outcome generated by the algorithm is both explainable to and understandable by PTRRS users [...]. “

206. Article 24 MiFID requires MiFID authorised firms to act honestly, fairly and professionally.

Analysis and Proposal

Transparency

207. With respect to transparency, as a general remark, ESMA reads such requirements as relating to the PTRR exercise as whole, and in particular to the rules governing a PTRR exercise and not as referring specifically or exclusively to the technical functioning of the algorithm.

208. This reading is in line with the interest of users in understanding how the service work, focusing more on the outcome of the algorithm, rather than on its technical mechanism. It

²⁵ The IOSCO Report indicates that in the roundtable held with users “Users displayed low interest in how the proprietary algorithms are designed, despite their limited ability to judge the effectiveness of the services and instead focuses on the outcomes generated by the algorithm.” Furthermore, IOSCO noted users do not feel the need of further due diligence, and indicated that they feel the good outcome of the exercise relates to the fairness of the algorithm.

is also worth noting a different interpretation would conflict with the proprietary nature of the algorithm.

209. Consistently with this interpretation, the draft RTS request providers to share the rules on the mode of operations of the exercise during the onboarding phase.
210. To further enhance transparency, and in line with the IOSCO recommendations, ESMA proposes to request PTRR service providers to ensure participants have a general understanding of how the algorithm operates, so that its outcome is understandable.
211. A general description of the algorithm provided to users could for example indicate the type of technology used (AI or ML) and focus on examples of possible outcomes given certain inputs.
212. Furthermore, ESMA would propose for the PTRR service providers to be available to discuss the outcome of the PTRR exercises with participants, to provide them with a better understanding of how the algorithm processes certain constraints and the relevant effects on the PTRR exercise outcomes. To this end, the PTRR service provider could share and discuss the Exercise Performance Report with participants.
213. Additionally, PTRR service providers should be required to retain the Exercise Performance Reports, or equivalent information, for a specified period, ensuring that participants can provide such reports upon request by their competent authority when they conduct their assessment on potential circumventions of the CO pursuant to Article 4 of EMIR.
214. Lastly, ESMA notes that the MiFID obligation to act honestly, fairly and professionally, applicable to providers as MiFID authorised firms, enhances the obligation for PTRR service provider to act in a “*reasonable, transparent and non-discriminatory manner*”.

Design and set of the algorithm

215. ESMA notes in the exercise the algorithm is key in ensuring compliance with certain specific requirements for the PTRR service exemption, such as market risk neutrality and risk reduction, but also non-discrimination among participants.
216. ESMA would thus propose that PTRR service providers ensure that the algorithm is designed and calibrated to achieve such objectives.
217. In particular, with respect to non-discrimination among participants, it would be important for the algorithm, to be “neutral” as regards the parties who submit the portfolios. In other terms, the algorithm is expected to produce the same outcome, upon the

submission of the same portfolios with the same risk tolerances, regardless of the entity owning the portfolio.

218. To ensure the good functioning of the algorithm the draft RTS require the PTRR provider to test it prior to its deployment or in case of any substantial update.

219. Furthermore, the PTRR service provider is required to prevent any external manipulation of the algorithm or of the PTRR exercise in general through the adoption of adequate safeguards.

4.4.2 Organisational requirements, controls, criteria to apply when assessing whether the CO is circumvented and compliance

Background

220. ESMA notes that the controls and monitoring set up in a the PTRR exercise play a key role in ensuring that the PTRR services comply with the different requirements set forth in EMIR and in the draft RTS.

221. Furthermore point (f) of paragraph 4 of Article 4b of EMIR expressly requires the PTRR service providers to “monitor the transactions resulting from the PTRR exercise in order to ensure, to the extent possible, that the PTRR exercise does not result in any misuse or circumvention of the clearing obligation”.

222. In addition, point (g) of paragraph 6 of Article 4b of EMIR mandates ESMA to specify the criteria to apply when assessing whether the clearing obligation is circumvented.

223. Market participants reported that in the current practice several controls take place in the different steps of each PTRR exercise. For example, before the PTRR execution checks are performed on the data relating to the transactions that are submitted to the PTRR exercise, whereas embedded checks are conducted on the Exercise Proposal produced by the Algorithm. Checks and controls pursue different objectives such as ensuring data quality, or market neutrality and consistency of the Exercise Proposal with the tolerances set by participants.

Analysis and Proposal

Organisational requirements

224. Firstly, ESMA proposes for PTRR service providers to have a clear and formalised governance arrangement, including clear lines of accountability, and effective procedures to monitor the correct functioning of the PTRR exercise, and in particular of the Algorithm.

225. To ensure the impartiality of the checks to be conducted on the algorithm, it is proposed for such arrangements to entail a separation of tasks and responsibilities between the staff running the PTRR exercises operations and the staff belonging to the control and/or compliance function.

226. Furthermore, to ensure adequate monitoring, and given the complexity of Algorithms, the draft RTS require the compliance staff to have a general understanding of how the algorithm operates and of how the PTRR exercises are conducted, they should also be in contact with the persons who have detailed technical knowledge of the algorithm.

Controls, criteria to apply to assess whether the clearing obligation is circumvented and compliance

227. The draft RTS also introduce a general obligation for the PTRR service providers to monitor and check that the output of each PTRR exercise complies with the requirements set forth in EMIR and in the draft RTS.

228. In particular, to avoid any possible misuse or circumvention of the CO, PTRR service providers should monitor that the PTRR exercise does not result in a circumvention of the CO. The criteria to be adopted by PTRR service providers to detect circumventions of the CO is whether the transactions resulting from a PTRR exercise result in an increase of uncleared net risk in the portfolios submitted to the PTRR exercise (see section 4.3.4 on the reasons for the adoption of this criteria to assess whether the CO is circumvented).

229. To prevent and detect any possible circumvention of the CO, providers should adopt specific measures and conduct ongoing targeted checks. For example, they should check that the Exercise Proposal complies with the risk reduction requirements set forth in the draft RTS, and in particular, that the PTRR exercise does not result in an increase of the net uncleared risk in the participants' portfolios.

230. In addition, any suspicious patterns in the participants' behaviour that could indicate attempts to misuse the exemption could be monitored and reported internally in order to allow the relevant function at the provider to prevent, to the extent possible, the misuse or circumvention in a timely manner. Therefore, the staff responsible for monitoring the outcome of the PTRR exercise should report to the compliance function cases of non-compliance with the requirements set out in EMIR and the draft RTS.

231. In turn, the compliance function should report such cases, in addition to cases of non-compliance identified on its own initiative, to the management body, which should take actions to prevent, to the extent possible, any possible attempts of misuse or circumvention of the CO.

232. Furthermore, the compliance function should produce yearly reports to the management body on the adequacy and effectiveness of the measures and procedures put in place to prevent any misuse or circumvention of the CO, as well as on any identified shortcomings and the remedial actions adopted.

Q9: Do you agree with ESMA's proposal on the obligations of the PTRR service providers concerning the Algorithm?

Q10: Do you think that the draft RTS should require PTRR service providers to adopt other specific measures to detect possible misuse or circumvention of the CO?

4.4.3 Requirements on the PTRR service agreement, the PTRR exercise elements and their management

Background

233. This section covers the general requirements for different PTRR services that shall be complied with by PTRR service providers, as set out by points (d) and (e) of paragraph 6 of Article 4b of EMIR.

234. As indicated in the previous sections of this CP, Article 17 of CDR 2017/567, supplementing MiFIR, details the elements of the PTRR service of Portfolio compression and their management by providers. Market participants reported that the same elements are currently widely adopted also in the provision of PTRR services under EMIR.

235. Therefore, ESMA proposes to introduce in the draft RTS provisions specifying the requirements on the PTRR service agreement, the elements of the PTRR exercise and their management.

Analysis and Proposal

236. The first aspect to be addressed is the contractual agreement that should be executed between the PTRR provider and the prospective participants in the PTRR exercise and the related legal documentation to be supplied by the provider. The PTRR service agreement should set out the standard processes governing access to and participation in the PTRR exercise as well as the terms and conditions upon which the provider offers the PTRR service.

237. The contractual agreement should clearly specify the eligibility criteria for entities who wish to become PTRR exercise participants and the providers' procedure to carry out periodic due diligence reviews on the clients' eligibility.
238. Concerning the PTRR exercise, the contractual agreement should describe in a clear and transparent manner the PTRR exercise process and its legal effects, including identifying the point in time at which each PTRR exercise becomes legally binding and when the resulting transactions are entered into.
239. As part of the description of the process of the exercise, providers should explain how PTRR exercises are planned. Point (a) of paragraph 4 of Article 4b of EMIR sets out that PTRR exercises shall be prescheduled. The exercises may take place intra-day or overnight, and their schedule shall be made available to participants ahead of time by the provider. Since this requirement is already envisaged in Article 4b, ESMA does not deem necessary to specify it further in the draft RTS.
240. Once an entity has signed the contractual agreement and decides to take part in the PTRR exercise, it should submit the transactions data concerning its portfolio and the data on counterparties exposures. Data is submitted by participants, whether directly, notably in the case of uncleared transactions, or indirectly, in the case of cleared transactions where it is submitted on participants' behalf by CCPs.
241. To ensure the successful outcome of the PTRR exercise, the PTRR provider should establish control measures to verify that the portfolios and the data provided are eligible for the PTRR exercise and to verify the integrity of the submitted data.
242. In addition, as described above (see section 4.3.6), providers shall allow participation in the PTRR exercise only to those entities that initially submitted a portfolio to the PTRR exercise.
243. As indicated in the ESMA 2020 PTRR service Report²⁶, risk tolerances are a crucial element of PTRR exercises. Generally, risk tolerances address how much change a participant would accept in its risk and as a cost, often expressed as a maximum change in a risk factor (sensitivity) e.g. per basis point of interest rate movement. Risk tolerances are used to allow the termination or replacement of transactions, particularly in portfolio compression exercises, even where there is no perfect offset between transactions. This is of particular importance in OTC portfolios with non-standardised transactions, as, without risk tolerances applied, trade compression would be reduced to the netting only of perfectly offsetting transactions.

²⁶ See Section 5.2.2 of Part 1.

244. For this reason, ESMA considers it necessary to explicitly address in the RTS the need for PTRR providers to consider participants' tolerance levels and ensure that they are not exceeded in the exercises' proposed output contained in the Exercise Proposal.
245. To that end, the PTRR service provider should be able to set constraints in the algorithm in order to keep the change in any risk factors within the tolerance levels set before the start of the exercise by the participants. The provider should also be able to verify that such constraints are complied with in the proposed output of the exercise.
246. ESMA understands from discussions with stakeholders that the current market practice is that platforms are made available by PTRR service providers to participants in order for the latter to express their tolerance levels. These platforms generally include pre-set tolerance levels for each exercise that providers allow, these pre-set levels depend on the type of exercise to be performed. Participants, therefore, select their desired tolerance levels within a range of pre-set tolerance levels. ESMA does not believe that this process goes against the requirement concerning compliance with participants' tolerance levels, described above. This is because the pre-set tolerance levels are only pre-selected by PTRR service providers in order to maximise efficiency of the PTRR exercise, depending on the specific algorithm that is going to be executed for that PTRR exercise and participants maintain the freedom to set their tolerance levels within a certain range.
247. At the same time, ESMA does not believe that the RTS should be prescriptive with regard to the tolerances' thresholds, as it is in the participants and the providers' interest to have low risk tolerances, which, again, are set to increase the efficiency of the PTRR exercise (see section 4.3.1).
248. Concerning the proposed output of the exercise, PTRR service providers should make it available to participants without delay. The proposal should be made through the Exercise Proposal, which should include at least i) identification of the counterparties included in the PTRR service; ii) change to the notional value of the derivatives; iii) change to the counterparty risk; iv) a breakdown of how different risks are reduced; v) details on how compliance with the risk tolerance specified by the participants was ensured, including the variation of the notional value of the derivatives compared to the specified risk tolerance and the variation of the counterparty risk compared to the specified risk tolerance; and vi) the information detailing how the proposed output leads to no increase in the aggregate net uncleared risk in the portfolio.
249. The Exercise Proposal should allow participants to clearly understand and evaluate the proposed output of the exercise in order to adopt an informed decision on whether to accept in full the output or reject it.

250. The generation of the proposed output should be governed by the contractual agreement described above. The contractual agreement should refer to the documentation provided during the client's onboarding, which should describe the process concerning the generation of the proposed output, including the timeframe for its acceptance by the participants. In particular, it should provide legal certainty as to the point in time when the acceptance of the proposal becomes legally binding for participants as well as when the proposed transactions are entered into.
251. In particular, the PTRR exercise proposed output may result in (partial or full) termination of transactions, replacement of transactions and/or addition of new transactions, for example in the case of the portfolio rebalancing service. Therefore, the legal documentation provided to the participants should determine the point in time, within the acceptance process of the exercise, in which such termination, replacement and addition of transactions become legally binding. ESMA believes that legal certainty around the execution of these operations should be required by the draft RTS.
252. ESMA notes that, as per the current market practice, following the execution of the algorithm, providers submit the Exercise Proposal to participants and the latter have a short time frame to accept or reject the proposed output. If every participant accepts the so-called dry run's output, then providers proceed with the booking of the amendment and/or generation of new transactions to be conducted by the PTRR service participants.
253. Lastly, it is worth considering whether a similar provision to that of paragraph 5 of Article 17 of CDR 2017/567 should be included. Article 17 provides for the conditions of portfolio compression to be complied with for the purpose of the exemption from the derivative trading obligation, transparency requirements and best execution under MiFIR. Paragraph 5 allows providers to grant participants additional time, even after the exercise output proposal, to add derivatives eligible for termination or reduction, in order to adjust the compression to the risk tolerance set by the participants and to maximise the efficiency of the portfolio compression.
254. So far, market participants did not report to ESMA any use of this provision for the purposes of the exemption from the CO under EMIR. On the contrary, as described in this section, PTRR exercise are pre-scheduled, hence participants know beforehand their dates and can prepare for the submission of their trades data in advance. After the deadline for submitting trades data to providers for the PTRR exercise, participants do not seem able to include additional data.
255. Therefore, ESMA proposes not to include a provision similar to that in paragraph 5 of Article 17 of CDR 2017/567 in the draft RTS, as it did not find reasons to maintain it, also on the basis of the current market practice.

Q11: Do you agree with the proposal regarding the requirements of the PTRR service agreement, the PTRR exercise elements and their management? Do you think that any requirements should be added or removed?

Q12: What do you think of the possibility of adding derivatives eligible for termination or reduction after the PTRR exercise output proposal? Should this possibility be introduced, do you think it would enable PTRR participants to influence the outcome of the exercise?

4.4.4 No influence over the result of the PTRR exercise by participating entities

Background

256. The provision requiring that entities participating in a PTRR exercise have no influence over the result of the PTRR exercise, set out in point (b) of paragraph 4 of Article 4b of EMIR, can be seen from two different angles. On the one hand, it can be seen considering the independence of the provider taking into account any existing relationship between the latter and the participants in the PTRR exercise. This aspect was already addressed in section 4.3.5, concerning the independence of the provider from the counterparties to the OTC derivative contracts included in the PTRR exercise. On the other hand, this requirement should be considered by looking at the influence that the participants may exert over the outcome of the PTRR exercise through their conduct, in cases where no appropriate safeguards are adopted by PTRR providers.

257. As highlighted in the ESMA 2020 PTRR Report²⁷, certain requirements should be envisaged preventing participants to cherry-pick which PTRR transactions are conducted as a result of the PTRR exercise (and which not), to avoid them influencing the outcome of the PTRR exercise.

258. As described above, the process leading to the execution of the PTRR exercise begins with the participating counterparties selecting the portfolios of trades to be included in the PTRR exercise. Following the selection of the portfolios and the submission of trades data, participants may set their tolerance levels for cases where it is not possible to find perfectly matching transactions.

259. After submitting the data related to the portfolios and setting their tolerances, participants should not have any further form of control over the exercise's outcome; from

²⁷ See Section 7.1, Part 3.

that moment, it is the provider's responsibility to apply the algorithm in a reasonable, and non-discriminatory manner, and submit the proposed outcome to the participants.

260. As a safeguard from the influence over the outcome of the exercise, point (c) of paragraph 3 of Article 4b of EMIR introduced the requirement that an exercise shall be only accepted in full or not accepted at all, and in the latter case, the whole exercise fails. Participants shall not be able to choose which trades within the proposed output to execute under the PTRR exercise. Consequently, after the PTRR service provider performs the PTRR exercise dry run on the submitted portfolios and share with the participants the Exercise Proposal, the latter may or may not accept the proposed output, but they cannot request any specific result.

261. On the providers' side, after having received the data on the participants' portfolios and their tolerance levels and applied the relevant constraints to the algorithm, it is their responsibility to run the exercise independently to generate an outcome that complies with the requirements of Article 4b of EMIR and to submit the proposed output of the exercise to the participants, without providing any advice.

262. The requirement, set out by point (d) of paragraph 4 of Article 4b of EMIR, for PTRR service providers to keep complete and accurate records of all transactions executed pursuant to a PTRR exercise is also an additional safeguard to ensure that participants are not influencing the outcome of the PTRR exercise. As described in section 4.4.6, these records shall be made available to competent authorities and ESMA when requested, allowing them, among other things, to potentially identify any patterns that suggest influence by the participants over the outcome of the PTRR exercise.

Analysis and proposal

263. ESMA notes that the requirement that an exercise shall be accepted in full or not accepted at all, preventing participants to choose which trades to execute, is already envisaged in point (c) of paragraph 3 of Article 4b of EMIR. Thus, ESMA does not believe it should be further specified in this section.

264. ESMA also notes that the obligation to prevent any influence over the result of the exercise is reinforced by the provision of point (a) of paragraph 4 of Article 4b of EMIR, requiring PTRR providers to act in a reasonable, transparent and non-discriminatory manner.

265. Moreover, point (a) of paragraph 3 of Article 4b of EMIR already envisages that a PTRR exercise shall be conducted independently by the PTRR service provider acting as a third-party.

266. Finally, providers need to comply with the conflict of interests requirements set out by MiFID and to specifically ensure the suitability and the adequacy of the conflict of interests policy adopted thereunder with the PTRR services (see section 4.3.5). Consequently, ESMA proposes to require in Article 6 of the draft RTS that PTRR service providers shall describe the circumstances which constitute or may give rise to a conflict of interest in the provision of the PTRR services and the procedures to be followed and measures to be adopted in order to prevent or manage the conflicts.

Q13: Do you think that other safeguards concerning the obligation not to influence the result of the PTRR exercise should be considered in the RTS?

4.4.5 Regularity of the compression exercise

Background

267. According to point (c) of paragraph 4 of Article 4b of EMIR, where PTRR exercises result in new PTRR transactions, providers shall undertake regular compression exercises.

268. As described above, new (offsetting) transactions are executed in the context of portfolio rebalancing exercises in order to reduce exposure to counterparties (see section 4.2.2.2). Through the creation of new transactions, the counterparty risk is redistributed among the PTRR participants. However, this comes at the cost of new transactions being booked, increasing the participants' total number of transactions and, consequently, the total notional amount of the transactions in a portfolio may increase.

269. Differently, a compression exercise allows providers to (partially or fully) terminate existing transactions where offsetting matching transactions are identified or to conduct replacement transactions, within certain tolerances (see section 4.2.2.1). As a result, regular portfolio compression exercises may prove useful in reducing the number of newly created transactions as part of portfolio rebalancing exercises and their total notional amount.

270. Considering the possibility of PTRR portfolio rebalancing exercises to generate new transactions, point (c) of paragraph 4 of Article 4b of EMIR requires PTRR service providers to reduce the operational risk by resorting to regular compression exercises.

Analysis and proposal

271. Since the requirement to undertake regular compression exercises, where PTRR exercises result in new PTRR transactions, is already set out by point (c) of paragraph 4 of Article 4b of EMIR, ESMA believes that it should not be further specified in the draft RTS.

Q14: Do you see the need to further specify in the draft RTS the requirement for PTRR providers to undertake regular compression exercises where PTRR exercises result in new PTRR transactions as set out in point (c) of paragraph 4 of Article 4b of EMIR?

4.4.6 Record-keeping of transactions executed pursuant to a PTRR exercise

Background

272. Point (d) of paragraph 4 of Article 4b of EMIR requires PTRR service providers to keep complete and accurate records of all transactions executed pursuant to a PTRR exercise. Such records shall include (i) the information on transactions entered into as part of the PTRR exercise, (ii) the transactions resulting from the PTRR exercise either as modified transactions or as new transactions, and (iii) the overall change in the risk of the different portfolios included in the PTRR exercise.

273. Additionally, point (e) of paragraph 4 of Article 4b of EMIR requires PTRR service providers to make available upon request and without undue delay the records referred to in point (d) to the relevant competent authority and to ESMA.

274. It is worth noting that these provisions do not require a specific format for the recording of the transactions executed pursuant to a PTRR exercise, nor for the reporting of those records to competent authorities and ESMA.

275. Under the MiFIR regime, pursuant to Article 17 of CDR 2017/567, the proposal for portfolio compression contains (i) the identification of the counterparties affected by the compression, (ii) the related change to the combined notional value of the derivatives, (iii) the variation of the combined notional amount compared to the risk tolerance specified. Similarly, the draft RTS requires to insert in the Exercise Proposal such information for all types of PTRR services and to add a breakdown of how the different risks are reduced and the information necessary to check the consistency between the risk tolerances submitted and the proposed outcome of the exercise.

276. ESMA understands from market participants that the Exercise Proposal used in the current practice already contains the information required in the draft RTS. Market participants also indicated that a report (the “Exercise Performance Report”) is produced

at the end of each exercise replicating the information contained in the Exercise Proposal for each executed exercise.

277. More in detail, the Exercise Performance Report includes the information required by point (d) of paragraph 4 of Article 4b of EMIR i.e., i) information on transactions entered into as part of the PTRR exercise, ii) transactions resulting from the PTRR exercise, either as modified transactions or as new transactions, and iii) the change in the risk of the different portfolios included in the PTRR exercise.
278. Furthermore, it details the risk reduction achieved per risk category and enables a comparison of the outcome of the PTRR exercise with the risk tolerances set by the participants prior to the run, as required by the draft RTS for the Exercise Proposal.
279. It is also worth recalling that counterparties participating in a PTRR exercise are subject to the reporting obligations set forth by Article 9 of EMIR and specified by the CDR on EMIR Reporting. In particular, point (c) of Article 7 of the CDR on EMIR Reporting requires counterparties to include, in the data to be reported, the PTRR Identifier (“PTRR ID”). The PTRR ID is a unique identifier provided by the PTRR service provider or a CCP in order to connect all derivatives entering into a given PTRR exercise and resulting from that PTRR exercise.

Analysis and proposal

Record keeping

280. To facilitate checks on the compliance with the market risk neutrality requirements detailed in the draft RTS, ESMA proposes that PTRR service providers include, in their records, evidence that the result of the PTRR exercise is market risk neutral.
281. Similarly, to facilitate checks by the competent authority on the requirements on risk reduction set forth in the draft RTS, ESMA proposes that the records kept by the providers should further detail the change in the risk of the different portfolios by including (i) a breakdown of how the different types of risks are reduced as a result of the PTRR exercise or kept within the tolerances expressed by the participants to the PTRR exercise; and (ii) the information showing that the PTRR exercise did not result in an increase in the aggregate net uncleared risk in the portfolio of any participant.
282. To facilitate the reconciliation between the data to be reported pursuant to the CDR on EMIR Reporting and the records to be kept by the PTRR service provider, ESMA proposes to include the abovementioned PTRR ID in the records to be kept by the PTRR service providers.

283. ESMA understands that the information required in the records is already shared with PTRR service participants through the Exercise Proposal and recorded through the Exercise Performance Report.

284. Therefore, to limit unnecessary regulatory burden on PTRR service providers, ESMA would encourage the use of the Exercise Performance Report to comply with the records keeping obligation set out in EMIR and in this draft RTS, provided that the required information is included. The Exercise Performance Report should be made available upon request, without undue delay, to the relevant competent authorities and to ESMA.

Storage and retention period

285. Moreover, ESMA considered whether the RTS should be prescriptive with regard to the means of data storage and the retention period.

286. In the spirit of burden reduction, ESMA does not propose to be prescriptive with regard to the means of data storage.

287. Concerning the retention period, ESMA has observed that the existing PTRR service providers already retain transactions data for a long period of time, as they use it for recalibrations and developments of the algorithm.

288. Therefore, ESMA proposes requiring a similar retention period to that required for trade repositories under paragraph 3 of Article 80 of EMIR. Also considering the current market practice, ESMA believes that this retention period is in line with the burden reduction objectives.

289. Moreover, it is worth noting that, in case PTRR service providers wish to retain the records for a longer period, for purposes other than compliance with this obligation (e.g., algorithm development), they remain free to do so, as the provision sets forth a minimum time of retention.

Q15: Can you confirm that the Exercise Proposal and the Exercise Performance Report contain the described information, and, in particular, the information required by the record keeping obligations under EMIR and the draft RTS? If this is not the case, please describe their content, highlighting the data which is missing in comparison to what is requested by EMIR and the draft RTS.

Q16: Do you agree with the draft RTS proposal on record keeping, including the proposed retention period?

Q17: In addition to the requirements described in the proposal, is there any other requirements which you would consider necessary to be further specified in the RTS? If yes, please detail the requirement and provide arguments supporting your answer.

4.5 Process for monitoring the application of the PTRR exemption

Background

290. Point (f) of paragraph 6 of Article 4b of EMIR mandates ESMA to specify the process for monitoring the application of the exemption of PTRR transactions from the CO. The scope of this mandate is thus to outline the process for the competent authorities of PTRR service providers to conduct such monitoring.

291. In particular, the process should cover the assessment, set out by paragraph 5 of Article 4b, to be conducted by PTRR service providers' competent authorities on whether providers continue to comply with the requirements referred to in paragraphs 3 and 4, following the competent authorities initial positive assessment referred to in point (b) of paragraph 5.

292. It is worth noting that this monitoring of the application of the PTRR exemption by the PTRRS providers' competent authorities, does not affect the crucial role and responsibility of the PTRR service participants' competent authorities in monitoring potential circumventions of the clearing obligation on the basis of Article 4 of EMIR. In particular, participants' competent authority are expected to contact the competent authorities of PTRR service providers' to cooperate and exchange information, and *vice-versa*, whenever there are grounds to suspect possible misuse or circumvention of the CO.

293. For this reason, the draft RTS provision on transparency requires PTRR service providers to retain, for a period of ten years, the information concerning the transactions executed pursuant to a PTRR exercise. This requirement should allow participants to request from the providers, and hence retrieve, such information when/if requested by their competent authorities, competent authorities may ask this information for the purpose of monitoring compliance with the CO under Article 4 of EMIR. This information may help competent authorities when checking the various conditions for when their supervised entities cleared or did not clear their OTC derivative transactions.

Assessment and Proposal

294. ESMA is of the view that the monitoring of the application of the exemption of PTRR transactions by the competent authority which authorised the PTRR service provider under MIFID could be conducted through the assessment of information to be submitted by PTRR service providers. To this aim, the PTRR service provider should confirm its compliance

with the requirements set out in paragraphs 3 and 4 of Article 4b of EMIR to its competent authority.

295. When submitting such confirmation, the PTRR service provider should also submit to its competent authority a report describing:

- any changes in the provider's conflict of interests policy and the records of any cases of conflict of interests, together with a description of how recorded conflicts of interests have been managed (Article 6 of the draft RTS);
- any changes in the provider's rules, methods and algorithms used to provide the PTRR service, along with a description of these changes, and the methodologies to develop and test them (Article 8 of the draft RTS);
- any changes to the provider's governance arrangement (Article 13 of the draft RTS);
- the reports submitted by the staff responsible for monitoring the outcome of the PTRR exercise to the compliance function concerning cases of non-compliance with the requirements set forth in EMIR and in the draft RTS (paragraph 4 of Article 14 of the draft RTS);
- the reports submitted by the compliance function to the management body, on the identification of any potential risks of misuse or circumvention of the clearing obligation (paragraph 5 of Article 14 of the draft RTS);
- the annual reports submitted by the compliance function to the management body on the adequacy and effectiveness of the measures and procedures put in place to prevent any misuse or circumvention from the clearing obligation, as well as on any identified shortcomings and the remedial actions taken (paragraph 6 of Article 14 of the draft RTS).

296. Competent authorities should be able to request from PTRR service providers any other information needed to carry out their assessment of compliance with paragraphs 3 and 4 of Article 4b of EMIR.

297. With regard to the frequency of the submission of the confirmation of compliance and of the reports, they should be submitted by PTRR service providers to their competent authorities for their assessment on an annual basis or upon request by the providers' competent authorities. Competent authorities of PTRR service providers may deem an assessment necessary where, for example, competent authorities of PTRR service participants share information with them indicating a potential circumvention of the

clearing obligation or where providers' competent authorities are notified by providers that a case of non-compliance occurred.

298. In addition to the reports mentioned in the paragraph above, PTRR service providers should notify, without undue delay, their competent authorities whenever there is a material change or planned material change in policies, rules, methods, algorithms and governance arrangements or a case of non-compliance occurs in relation to any of the requirements of paragraphs 3 and 4 of Article 4b of EMIR.

5 Considerations on the transactions to be recorded for the purpose of the exemptions under MiFIR

Background

299. The new Article 31 of MiFIR expands the exemption from the transparency requirements, the DTO and the best execution verification, previously foreseen for compression to all transactions in OTC derivatives that are "*formed and established as a result of a post trade risk reduction service*".

300. Recital 35 of MiFIR Review explains that compression is a subset of PTRR services and identifies in the technical and non-price forming nature of the transactions resulting from the PTRR services the rationale for the MiFIR exemptions.

301. In addition, the new Article 31 of MiFIR requests PTRR service providers to keep complete and accurate record of the transactions which are not already recorded in accordance with EMIR, and to make those records available to the relevant competent authority or ESMA promptly upon request.

302. Paragraph 4 of Article 31 of MiFIR contains a mandate for a possible Delegated Act for the EC under MiFIR to specify the exemptions. The mandate requires the EC to specify:

- (a) PTRR services for the purpose of the exemption; and
- (b) the transactions to be recorded by PTRR service providers.

303. Pursuant to the mandate under point (a) of such provision, the MiFIR DA amending CDR 2017/567 introduces in the CDR 2017/567 a new Article 16a which identifies the conditions for PTRR services for the purposes of the MiFIR exemption, and indicates that "*compression services, rebalancing services, and basis risk optimisation services*" are eligible type of PTRR services for the MiFIR exemptions (see section 3.2 on PTRR service provisions in MiFIR).

304. To assist the EC in the part of the mandate under Article 31 of MiFIR regarding the transactions to be recorded by PTRR service providers, in the following section ESMA makes some considerations regarding the record keeping obligations under MiFIR.

Assessment and Proposal

305. ESMA firstly notes that the conditions set forth by MiFIR DA amending CDR 2017/567 to identify PTRR services eligible for the MiFIR exemptions are also listed by EMIR as requirements for the PTRR exemption under EMIR. Furthermore, both MiFIR and EMIR identify as eligible types of services for the purpose of the respective exemptions compression, rebalancing and basis risk optimisation.

306. However, the requirements under EMIR for the PTRR exemption are more numerous and detailed, given the need in EMIR to avoid any circumvention of the CO. As a result, a possible misalignment may occur between the scope of the MiFIR and EMIR exemptions, and certain PTRR services may be eligible only for the MiFIR exemptions.

307. Given the interest of PTRR service providers to increase the attractiveness of the PTRR services by allowing their clients to benefit from both the MiFIR and EMIR exemptions, the cases of misalignment is expected to be limited, but cannot however completely be discarded.

308. Taking into consideration the case where a PTRR service may benefit only from the MiFIR exemptions, MiFIR requests PTRR service providers to keep complete and accurate record of the transactions which are not already recorded in accordance with EMIR and make those records available to the relevant competent authority or ESMA promptly upon request.

309. To allow the competent authorities to have an overview of the PTRR exercise, as previously prescribed by Article 18 of CDR 2017/569 for compression, ESMA would recommend for the transactions to be recorded under MiFIR to include for each exercise at least:

- a) the list of derivatives submitted to the PTRR exercise;
- b) the list of derivatives changed or terminated during the PTRR exercise; and
- c) the list of derivatives added or used to replace previous derivatives.

310. In addition, ESMA points to the importance of including in the records the information from which compliance with the requirements contained in the new Article 16a of CDR 2017/567 for the MiFIR exemptions can be checked (market risk neutrality, the risk

reduction objective of the PTRR exercise and the non-price forming nature of the transactions used to perform the PTRR exercise).

311. In this respect, ESMA recalls that such information is expected to be included in Exercise Proposal and in the Exercise Performance Report produced in the PTRR exercises. A specific question is inserted in the CP to collect information on the content of the Exercise Proposal and of the Exercise Performance Report from market participants.

312. As a result, similarly to what is proposed for the EMIR draft RTS, ESMA would recommend to include in the record keeping obligation under MiFIR the information displaying the market risk neutrality of the PTRR exercise, its risk reduction objective and the non-price forming nature of the transactions used to perform it.

313. In line with the SBR objective, and subject to the outcome of the present consultation, ESMA would also suggest to permit to comply with this obligation by using the Exercise Proposal and/or the Exercise Performance Report already produced in the current practice, provided that they contain the information necessary for the competent authority to check the requirements under CDR 2017/567 for MiFIR exemptions.

Q18: Do you agree with the recommendation made regarding record keeping under MiFIR?

6 Annexes

6.1 Annex I – Summary of questions

Q1: Do you agree with the description and analysis of PTRR services, portfolio compression, portfolio rebalancing, and basis risk optimisation? If not, why?

Q2: Do you know other types of PTRR services? Please elaborate.

Q3: Do you agree with ESMA proposal on market risk neutrality? If not, why?

Q4: Can you please provide information on how are tolerances usually set in a PTRR exercise, and what is their level, if possible? Do you think some criteria should be set to identify appropriate risk tolerances?

Q5: Do you agree with ESMA analysis and proposal on risk reduction by PTRR services? Do you think any additional criteria should be used to determine risk reduction in PTRR services?

Q6: Do you agree with ESMA proposal relating to the safeguards to avoid a circumvention of the CO? Would you add specific limitations regarding the composition of the portfolios subject to the exercise (e.g. uncleared portfolios only for compression)? Please justify your answer.

Q7: Do you agree with ESMA proposal on the independence of the provider from the parties to the OTC derivatives contracts included in the exercise?

Q8: Do you agree with ESMA proposal on the information to be provided to clients?

Q9: Do you agree with ESMA proposal on the obligations of the PTRR service providers concerning the algorithm?

Q10: Do you think that the draft RTS should require PTRR service providers to adopt other specific measures to detect potential misuse or circumvention of the CO?

Q11: Do you agree with the proposal regarding the requirements of the PTRR service agreement, the PTRR exercise elements and their management? Do you think that any requirements should be added or removed?

Q12: What do you think of the possibility of adding derivatives eligible for termination or reduction after the PTRR exercise output proposal? Should this possibility be introduced, do you think it would enable PTRR participants to influence the outcome of the exercise?

Q13: Do you think that other safeguards concerning the obligation not to influence the result of the PTRR exercise should be considered in the RTS?

Q14: Do you see the need to further specify in the draft RTS the requirement for PTRR providers to undertake regular compression exercises where PTRR exercises result in new PTRR transactions as set out in point (c) of paragraph 4 of Article 4b of EMIR?

Q15: Can you confirm that the Exercise Proposal and the Exercise Performance Report contain the described information, and, in particular, the information required by the record keeping obligations under EMIR and the draft RTS? If this is not the case, please describe their content, highlighting the data which is missing in comparison to what is requested by EMIR and the draft RTS.

Q16: Do you agree with the draft RTS proposal on record keeping, including the proposed retention period?

Q17: In addition to the requirements described in the proposal, is there any other requirements which you would consider necessary to be further specified in the RTS? If yes, please detail the requirement and provide arguments supporting your answer.

Q18: Do you agree with the recommendation made regarding record keeping under MiFIR?

6.2 Annex II – Draft technical standards further specifying the requirements for PTRR services with regards to the exemptions from the CO

COMMISSION IMPLEMENTING REGULATION (EU) .../...

of XXX

laying down regulatory technical standards supplementing Regulation (EU) 648/2012 of the European Parliament and of the Council with regard to the exemption of the transactions resulting from PTRR services from the clearing obligation

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ⁽²⁸⁾, and in particular Article 4b, thereof,

Whereas:

- (1) Regulation (EU) No 648/2012 has been amended by Regulation (EU) 2024/2987 of the European Parliament and of the Council ⁽²⁹⁾. Those amendments have, inter alia, introduced an exemption from the clearing obligation for OTC derivative contracts that are initiated and concluded as a result of an eligible post-trade risk reduction ('PTRR') exercise ('PTRR transaction') carried out pursuant to paragraph 2 to 4 of Article 4b Regulation (EU) No 648/2012. To provide clarity and legal certainty to the participants of PTRR exercises and to PTRR service providers, it is necessary to further specify the requirements contained in such provisions.
- (2) In particular, considering that PTRR services should take the form of compression, rebalancing or optimisation or a combination thereof for the purposes of the exemption laid down in Article 4b of Regulation (EU) No 648/2012, it is necessary to identify the

²⁸ OJ L201, 27.7.2012, p.1

²⁹ OJ L, 2024/2987, 4.12.2024

main features and the objectives of such types of PTRR services. To enhance clarity, the term “basis risk optimisation” is used in this Regulation to refer to “optimisation”.

- (3) In addition, it is important to determine what constitute market risk neutrality in a PTRR exercise and the required risk reduction in submitted portfolios. In particular, it is important to specify that market risk neutrality would mean that the PTRR exercise does not change, or changes only within the small tolerances set by the participants in the exercise, the market risk of the portfolios submitted to the PTRR exercise. Similarly, it is important to clarify that a PTRR exercise achieves risk reduction when the overall risk of each portfolio submitted to the PTRR exercise is reduced, while certain specific risk types contributing to the overall risk, such as the counterparty risk, may increase within the tolerances that are set by participants in the exercise. Furthermore, to avoid any circumvention of the clearing obligation, it is important for the PTRR exercise to not increase the aggregate net uncleared risk in any of the portfolios submitted to the PTRR exercise, whereby uncleared risk would mean the risk deriving from bilateral transactions not cleared via a CCP.
- (4) To ensure that a PTRR service provider is independent from the participants in the PTRR exercise, a PTRR service provider, when complying with its obligation to establish a conflict of interests policy under Directive (EU) 2014/65, should pay special attention to the circumstances which constitute or may give rise to a conflict of interest in the provision of the PTRR services. This could be for example the case where one of the participants in the PTRR exercise is an entity that is part of the same group as the PTRR service provider.
- (5) When establishing its conflict of interest policy regarding the PTRR service, the PTRR provider should consider that disclosure of specific conflicts is a measure of last resort to be used only where the organisational and administrative arrangements established by the PTRR service provider to prevent or manage its conflicts of interest are not sufficient to ensure that the risks of damage to the interests of the participants in the PTRR exercise are prevented. Thus, the conflict of interest policy should not over rely on disclosure, and adequately consider effective organisational and administrative arrangements to appropriately prevent and manage conflicts of interest.
- (6) In order to give to participants in the PTRR exercise all necessary information, in the process which leads to the conclusion of the service agreement (onboarding), PTRR service providers should describe to clients the mode of operation of a PTRR exercise, highlighting the actions which they are required to perform in the PTRR exercise.
- (7) To ensure transparency regarding the PTRR exercise, including as regards to the rules, methods and algorithms used in a pre-scheduled cycle, PTRR service providers should, without being compelled to reveal any intellectual property, explain to participants in the PTRR exercise how the outcome of the PTRR exercise is generated. For the same reason, PTRR service providers should provide participants in the PTRR exercise with information on the outcome of each PTRR exercise they participate to in a durable medium as defined in point 62 of Article 4(1) of Directive (EU) 2014/65, for example by

making available the exercise performance report and be available to explain the information contained therein.

- (8) PTRR service providers should retain the information concerning the transactions executed pursuant to the PTRR exercise for a period of ten years. This requirement should allow participants in the PTRR exercise to retrieve such information when requested by their competent authorities for the purpose of monitoring the PTRR transactions exemption from the clearing obligation pursuant to Article 4 of EMIR.
- (9) In order to ensure legal certainty and operational transparency in the provision of PTRR services, it is essential that PTRR service providers enter into binding service agreements with PTRR service participants. These agreements shall clearly define the procedural framework and legal effects of each PTRR exercise.
- (10) To uphold the effectiveness of PTRR services, PTRR service providers should implement a robust preliminary phase prior to the execution of the algorithm. These preparatory steps are fundamental to ensuring that the PTRR exercise is conducted in a reasonable and non-discriminatory manner, and that the resulting transactions are aligned with the participants' risk tolerances.
- (11) To ensure transparency and alignment with participants' risk profiles, PTRR service providers should, following the execution of the algorithm, submit to each participant a comprehensive PTRR exercise output proposal.
- (12) As a part of its overall governance framework and decision-making framework, a PTRR service provider should have a clear and formalised governance arrangement, including clear lines of accountability, effective procedures for the communication of information and a separation of tasks and responsibilities. That arrangement should avoid key man dependency risk.
- (13) To uphold the integrity of the derivatives market and ensure adherence to the clearing obligation, PTRR service providers should ensure that PTRR cycles fulfil the requirements set forth in article 4b of Regulation (EU) 648/2012. In particular, PTRR services should proactively mitigate any risk of circumvention of the clearing obligation by performing ongoing checks on the PTRR service exercise execution. The criteria to be applied by PTRR service providers to assess whether the clearing obligation is circumvented should be the increase of the aggregate net uncleared risk in the portfolio of any participant in a PTRR exercise, as set forth in point c) of Article 5 of this Regulation.
- (14) Relevant competent authorities need to have full access to records of the transactions executed pursuant to a PTRR exercise in order to be able to monitor the application of the exemption from the clearing obligation. For this purpose, given the specificities of PTRR services, records kept by PTRR service providers should include information on market risk neutrality, reduction of risks, compliance with the participants' risk tolerances and evidence that the exercise did not result in an increase in the aggregate net uncleared risk in any participants' portfolio.

- (15) The retention period for records of transactions executed pursuant to a PTRR exercise, which are to be maintained by PTRR service providers, should be aligned with the retention period set out in Article 80(3) of Regulation (EU) No 648/2012 of the European Parliament and of the Council.
- (16) For the purposes of monitoring the application of the exemption granted, the process that competent authorities of PTRR service providers would follow should be based on an assessment of the provider's compliance with paragraphs 3 and 4 of Article 4b of Regulation (EU) No 648/2012 of the European Parliament and of the Council. This assessment should be carried out at least annually or when deemed necessary by the competent authority. Competent authorities of PTRR service providers may deem an assessment necessary where, for example, competent authorities of PTRR service participants share information with them indicating a potential circumvention of the clearing obligation or where providers' competent authorities are notified by providers that a case of non-compliance occurred.
- (17) This Regulation is based on the draft regulatory technical standards submitted to the Commission by the European Securities and Markets Authority (ESMA).
- (18) ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the advice of the Securities Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council³⁰.

HAS ADOPTED THIS REGULATION:

CHAPTER I

REQUIREMENTS FOR DIFFERENT TYPES OF PTRR SERVICES

Article 1

Compression

Transactions resulting from a compression exercise are eligible for the exemption from the clearing obligation set out in Article 4b of Regulation (EU) No 648/2012 when in the PTRR

³⁰ Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

exercise 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 other derivatives whose combined notional value is less than the combined notional value of the terminated derivatives.

Article 2

Portfolio rebalancing

Transactions resulting from a portfolio rebalancing are eligible for the exemption from the clearing obligation set out in Article 4b of Regulation (EU) No 648/2012 when in the PTRR exercise counterparty risk is reduced in an existing portfolio of trades by adding new non-price forming trades and where no existing trade in the portfolio is terminated or replaced and the notional is increased rather than decreased.

Article 3

Basis risk optimisation

Transactions resulting from a basis risk optimisation are eligible for the exemption from the clearing obligation set out in Article 4b of Regulation (EU) No 648/2012 when in the PTRR exercise basis risk is reduced in an existing portfolio of hedged trades by adding non price forming trades and where no existing trade in the portfolio is terminated or replaced and the notional is increased rather than decreased.

CHAPTER II

REQUIREMENTS OF THE PTRR EXERCISES

Article 4

Risk Reduction

1. PTRR exercises can be performed on portfolios containing both cleared and uncleared transactions, provided that the PTRR exercise achieves risk reduction, as specified in the following paragraph.
2. For the purposes of point b) of paragraph 3 of Article 4b of Regulation (EU) No 648/2012, risk reduction is achieved when the PTRR exercise fulfils all of the following conditions:

- (a) it reduces the overall risk of each portfolio submitted to the PTRR exercise;
- (b) specific types of risk contributing to the overall risk are increased only within the tolerances set by the participants to the PTRR exercise specifically for each exercise;
- (c) it does not increase the aggregate net uncleared risk in any of the portfolios submitted to the PTRR exercise.

Article 5

Market risk neutrality

1. For the purposes of point e) of paragraph 3 of Article 4b of Regulation (EU) No 648/2012, a PTRR exercise is market risk neutral when before and after the PTRR exercise is performed the market risk of all the portfolios submitted to the PTRR exercise remains the same or within the tolerances set by the participants in the PTRR exercise.
2. A PTRR service provider shall ensure that the tolerances set by the participants in the PTRR exercise are minimal and do not affect significantly the overall exposure of their portfolios towards market risk.

CHAPTER III

OPERATING CONDITIONS FOR PTRR SERVICE PROVIDERS

Article 6

Conflict of interests

1. A PTRR service provider shall describe in a dedicated part of the conflict of interests policy laid down in Article 34 of Commission Delegated Regulation (EU) 2017/565 the circumstances which constitute or may give rise to a conflict of interest in the provision of the PTRR services and the procedures to be followed and measures to be adopted in order to prevent or manage such conflict.
2. A PTRR service provider shall keep records of when, during the execution of the PTRR service, a conflict of interest as referred to in paragraph 1, may arise.

Article 7

Rules of the PTRR exercise, including methods and algorithms

A PTRR service provider shall design and set the rules of the PTRR exercise, including the pre-agreed rules, methods and algorithms used to run a PTRR exercise in a way that ensures that the PTRR exercise fulfils all of the following conditions:

- (a) it is market risk neutral, as specified in Article 4 of this Regulation;
- (b) it achieves risk reduction, as specified in Article 5 of this Regulation and;
- (c) it does not discriminate among participants in the PTRR exercise.

Article 8

Testing and safeguards

1. Prior to the deployment or substantial update of the rules, methods and algorithms used to provide the PTRR service, a PTRR service provider shall establish clearly delineated methodologies to develop and test the new rules, methods and algorithms used to provide the PTRR service.

2. A PTRR service provider shall adopt safeguards to prevent any external manipulation of the PTRR exercise.

Article 9

Transparency

1. Prior to the conclusion of the service agreement, a PTRR service provider shall describe to clients the mode of operations of a PTRR exercise, including the actions required in each step of the exercise to the counterparties to the PTRR transactions. The description shall contain enough information on the pre-established rules of the PTRR exercise, including methods and algorithms, to allow clients to understand how the PTRR service operates.

2. When providing information on the PTRR service, a PTRR service provider shall ensure that participants in the PTRR exercise are aware that:

(a) the exercise is open for participation only to entities that initially submitted a portfolio to the PTRR exercise; and

(b) each exercise shall be accepted in full and, as a result the participant in the PTRR exercise shall not be able to choose which trades to execute under the PTRR exercise.

When providing such information, the PTRR service provider shall specify that participants remain free to not take part to a run if the outcome is not in line with their risk reduction targets or management.

3. After the performance of a PTRR exercise, a PTRR service provider shall promptly transmit to participants in the PTRR exercise the information on the transactions executed pursuant to the PTRR exercise in a durable medium. The information shall include the content of the records to be kept by the PTRR service provider pursuant to Article 15 of this Regulation. A PTRR service provider shall retain such information for a period equivalent to the retention period referred to in Article 16 of this Regulation and, upon request, make it available in a durable medium to participants in the PTRR exercise.

4. A PTRR service provider shall provide a sufficient and reasonable level of information at the request of a participant in the PTRR exercise to explain the outcome of the PTRR exercise and to facilitate its understanding of how the pre-established rules of the PTRR exercise, including methods and algorithms used in the pre-scheduled cycle, take into account portfolios submitted to the PTRR exercise and tolerances set.

Article 10

PTRR service agreement

1. A PTRR service provider shall conclude a PTRR service agreement with the participants in the PTRR exercise. The agreement shall cover the PTRR service process and its legal effects, including identifying the point in time at which each PTRR exercise becomes legally binding.

2. The agreement referred to in the first paragraph shall include all relevant legal documentation describing how and when derivatives submitted for inclusion in the PTRR service are terminated or replaced by other derivatives and how and when new derivatives are added as part of the PTRR exercise.

Article 11

Preliminary phase of the PTRR exercise

Prior to the execution of the algorithm, a PTRR service provider shall execute all of the following steps:

(a) verify the eligibility of the portfolios submitted by participants to providers for the PTRR exercise and the integrity of the submitted data; and

(b) require each participant in the PTRR exercise to specify their risk tolerances including the potential exclusion of PTRR transactions with certain counterparties and the specification of limits regarding counterparty risk, market risk and cash payment tolerances.

Article 12

PTRR exercise output proposal

1. Following the execution of the algorithm, a PTRR service provider shall submit to each participant a PTRR exercise output proposal that includes the following information:

- (a) identification of the counterparties included in the PTRR service;
- (b) change to the notional value of the derivatives;
- (c) change to the counterparty risk;
- (d) a breakdown of how different risks are reduced;
- (e) details on how compliance with the risk tolerances specified by the participants was ensured, including the variation of the notional value of the derivatives compared to the specified risk tolerances and the variation of the counterparty risk compared to the specified risk tolerances; and
- (f) details on how the proposed output leads to no increase in the aggregate net uncleared risk in the portfolios submitted to the PTRR exercise.

2. A PTRR service provider shall only validate the PTRR exercise output once all participants have agreed to the PTRR exercise output proposal and within a pre-defined timeframe.

Article 13

Organisational requirements

1. A PTRR service provider shall establish controls and closely monitor the execution of the PTRR exercises, through a clear and formalised governance arrangement, setting out:

- (a) the procedures to monitor the PTRR exercise and the application of the rules, methods and algorithms used to run them; and
- (b) an allocation of tasks ensuring clear lines of responsibility, including a separation of tasks and responsibilities between the staff running the PTRR exercise and the staff running the supporting functions, in particular the risk and control as well as compliance function.

2. A PTRR service provider shall ensure that its compliance staff has a sufficient level of knowledge on the rules of the PTRR exercise, including methods and algorithms used to run the exercise. The PTRR service provider shall ensure that its compliance staff can contact at any point in time throughout the execution of the exercise the staff responsible for running the PTRR exercise, in particular the staff who have detailed technical knowledge of the rules of the PTRR exercise, including the methods and algorithms used to run the PTRR cycle.

Article 14

Controls and compliance

1. A PTRR service provider shall monitor and check that the outcome of each PTRR exercise complies with the requirements set forth in Article 4b of Regulation (EU) No 648/2012 and in this Regulation.

2. In particular, a PTRR service provider shall ensure that the proposal resulting from the application of the rules, methodologies and algorithms in each exercise complies with the requirements on market risk neutrality and risk reduction and laid down in Article 4 and 5 of this Regulation respectively through embedded checks.

3. A PTRR service provider shall adopt specific measures and conduct targeted ongoing checks, to ensure that the PTRR exercise does not result in the misuse or the circumvention of the clearing obligations. In order to detect circumventions of the clearing obligation, the PTRR service provider shall ensure that the PTRR exercise do not increase the aggregate net uncleared risk in the portfolio of any participant in a PTRR exercise.

4. Staff responsible for monitoring the outcome of the PTRR exercise shall report to the compliance function cases of non-compliance with the requirements set forth in Article 4b of Regulation (EU) No 648/2012 and in this Regulation. The compliance function shall assess that information, take appropriate action and record it.

5. The compliance function shall report to the management body, without undue delay, upon the identification of any potential risks of misuse or circumvention of the clearing obligation.

6. In addition, the compliance function shall report, at least annually, to the management body on the adequacy and effectiveness of the measures and procedures put in place to prevent any misuse or circumvention from the clearing obligation, as well as on any identified shortcomings and the remedial actions taken.

Article 15

Record keeping

In the records to be kept pursuant to paragraph 4(d) of Article 4b of Regulation (EU) No 648/2012, a PTRR service provider shall include:

- (a) the PTRR ID referred to in Article 7 of Commission Delegated Regulation (EU) 2022/1855;
- (b) the information indicating that the result of the PTRR exercise is market risk neutral;
- (c) a breakdown of how the different types of risks are reduced, in each of the portfolios submitted to the PTRR exercise, as a result of the PTRR exercise or kept within the tolerances expressed by the participants in the PTRR exercise;
- (d) the information showing that the PTRR exercise did not result in an increase in the aggregate net uncleared risk in the portfolio of any participant.

Article 16

Retention period of records of transactions executed pursuant to a PTRR exercise

A PTRR service provider shall maintain the records referred to in paragraph 4(d) of Article 4b of Regulation (EU) No 648/2012 for at least 10 years following the performance of a PTRR exercise.

CHAPTER IV

PROCESS FOR MONITORING THE APPLICATION OF THE EXEMPTION

Article 17

Process for monitoring the application of the exemption

1. To monitor the application of the exemption from the clearing obligation envisaged in Article 4b of Regulation (EU) No 648/2012, competent authorities of PTRR service providers shall assess the providers' compliance with paragraph 3 and 4 of Article 4b of Regulation (EU) No 648/2012, as set out in paragraph 5 of Article 4b of Regulation (EU) No 648/2012, second and fourth subparagraphs.
2. In order to enable their competent authorities to carry out the assessment referred to in the first paragraph, PTRR service providers shall confirm that they comply with the requirements of paragraphs 3 and 4 of Article 4b of Regulation (EU) No 648/2012 to their competent authorities.

3. When confirming compliance pursuant to paragraph 2 of this Article, the PTRR provider shall submit a Report including:

(a) any changes in the provider's conflict of interests policy and conflicts of interests occurred during the year and how they have been managed;

(b) any changes in the provider's rules, methods and algorithms used to provide the PTRR service referred to in Article 8 and in the methodologies to develop and test them;

(c) any changes to the provider's governance arrangement referred to in Article 13; and

(d) the reports referred to in paragraphs 4, 5 and 6 of Article 14 of this Regulation.

4. Competent authorities may request from PTRR service providers any other information needed to carry out the assessments referred to in the first paragraph.

5. The confirmation described in paragraph 2 of this Article shall be submitted on an annual basis or upon request by the competent authority.

6. Whenever there is a material change or planned material change in policies, rules, methods, algorithms and governance arrangements or a case of non-compliance occurs in relation to any of the requirements of paragraphs 3 and 4 of Article 4b of Regulation (EU) No 648/2012, PTRR service providers shall, without undue delay, notify their competent authorities.

CHAPTER VI

FINAL PROVISIONS

Article 18

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission

The President

[For the Commission

On behalf of the President

[Position]

6.3 Annex III – IOSCO Report and Requirements under EU Regulations

In the IOSCO PTRRS Report, IOSCO after acknowledging the benefits that PTRR services provide, such as the reduction of risk and improved efficiency, identifies the risks that the use of PTRR services may pose to the OTC markets and its participants. The identified risks relate to control and governance around algorithms, fair treatment of participants, data protection, legal certainty, and operational resilience. The IOSCO PTRRS Report presents seven sound practices to address such risks.

The seven sound practices focus on

- 1) Transparency, governance, comprehensibility and fairness of the algorithm;
- 2) Operational risk;
- 3) Data integrity and security and regulatory data;
- 4) Legal certainty;
- 5) Considerations of potential counterparty risk by IOSCO members and PTRR services users;
- 6) Market concentration and competition;
- 7) Standardization and predictability of runs and file formats.

While some practices are addressed to users and/or providers (e.g. Transparency, governance, comprehensibility and fairness of the algorithm), some others are addressed to regulators (e.g. market concentration and competition).

ESMA notes that the content of most of the practices addressed to users and/or providers correspond to requirements provided by EMIR to benefit from the PTRR service exemption. In particular, the best practices identified by IOSCO often correspond to obligations for investment firms to be MIFID authorised, where the MiFID authorisation is a condition to make use of the exemption under EMIR.

The table below reports for each IOSCO best practice the corresponding article under EMIR and MIFID or MIFIR.

As a result, ESMA notes the introduction of the PTRR service exemption is likely to result in the alignment of the providers and users with most the practices identified by IOSCO on PTRR services.

Nevertheless, ESMA kept in consideration the practices identified by IOSCO when developing the proposed RTS in order to further align the proposed RTS with the IOSCO best practices or better tailor certain requirements provided by MiFID for investment services to the specific features of the PTRR service providers.

The table below reports for each IOSCO best practice the corresponding article under EMIR and MIFID or MIFIR.

CORRESPONDING EU PROVISIONS TO IOSCO BEST PRACTICES

IOSCO sound Practices and consideration	EU requirements
1 As part of reasonable due diligence PTRRS users should aim to have a basic, understanding of the design of the proprietary risk reduction algorithm(s) used by the service provider. PTRRS providers should aim to ensure that, without revealing any intellectual property, there should be appropriate, high-level transparency around the algorithm used and proper controls and governance around it, including regarding the use of Artificial Intelligence (AI) and Machine Learning (ML). Users should aim to ensure that the overall outcome generated by the algorithm is both explainable to and understandable by PTRRS users.	EMIR Article 4b, paragraph 4, point a and draft RTS Article 9
Users should aim to ensure the resulting trades from PTRRS remain market-risk neutral within the tolerances set by the users and the output of the algorithm should be validated against a series of embedded checks.	EMIR Article 4b, paragraph 3, point e and Article 14 draft RTS
The PTRRS users should not be able to pick the resulting trades from PTRRS: they shall accept all or none of the resulting trades.	EMIR Article 4b, paragraph 3, point c
2 As a sound practice to mitigate potential operational risks, PTRRS users should seek to ensure via their due diligence and risk management practices that PTRRS service providers have established back-up measures and processes in case of a provider outage or during a wind-down	MiFID Article 16 paragraph 4, and CDR 2017/565 Article 21-23 MiFID Article 48

3	As a sound practice, PTRRS users should aim to ensure via their due diligence that established systems and procedures are in place for robust data management and safekeeping of commercially sensitive data on the portfolio of the clients	MiFID Article 16 and Article 24, GDPR and ESMA Guidelines
4	As a sound practice, PTRRS users should seek to ensure that there is proper disclosure and controls around PTRRS documentation to ensure legal certainty around the timing of execution and confirmation of new trades, and the legal documentation with the PTRRS provider, such that the process and contractual terms of the service are clear and unambiguous, in compliance with regulatory requirements, including trade reporting.	Draft RTS Articles 10-14
5	PTRRS users should continue to monitor their portfolios to confirm that counterparty risk is reduced following a counterparty risk optimisation/rebalancing exercise. PTRRS users should analyse whether participating in a risk mitigation run may have increased exposures to particular counterparties (even though the new transactions should have reduced a user's overall gross notional exposure or basis risk and resulted in lower IM).	N/A
6	<p>IOSCO members should observe carefully:</p> <ul style="list-style-type: none"> - The implications of market concentration among PTRRS providers and whether market concentration results in any potential risks to PTRRS users; - The level of competition among providers and if a low level of competition is having negative impacts on innovation, pricing and quality of services, with the objective to ensure the service provision is the most cost beneficial service to the PTRRS users; and - The onboarding procedure and access to PTRRS is fair, particularly in the case of smaller firms. <p>In addition, in the event of insolvency of a major PTRRS provider, change of PTRRS providers should be achievable to facilitate a transfer to another service provider.</p>	N/A
7	Where appropriate, PTRRS users should consider requesting PTRRS providers standardize their file formats and data collection practices. Changes in file format to submit transactions to the PTRRS provider should be limited to the extent possible. Users should consider requesting from their PTRRS provider predictable and transparent scheduling and running of the exercises.	EMIR Article 4b, paragraph 4, point d + RTS Article 15