



European Securities and Markets Authority, ESMA
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– Submitted online via ESMA's website –

19 March 2012

Comments of the EAPB on the ESMA discussion paper on Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories

Dear Madam or Sir,

The European Association of Public Banks, EAPB, welcomes the opportunity to comment on the ESMA discussion paper on Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories.

Answers to selected questions:

Q3. Market participants currently already rely on various types of standardised contractual documentations (master agreements). Because of their high level of standardisation and as they address key legal issues, in particular close-out netting, they are an important element for mitigating legal and counterparty risks. It could therefore be considered to recommend that indirect clearing arrangements be based on these master agreements. The requirements should however not recommend or mandate the use of one specific type of master agreement. Rather, market participants must continue to have a sufficient degree of choice to select the master agreements which best ensures compliance with applicable legal/regulatory requirements and which is also best suited to their needs and operational capabilities. Counterparties should also generally be able to select the contractual language as well as the applicable law/jurisdiction. It has to be taken into account that the contractual framework needs to be sufficiently transparent and also operationally manageable for all counterparties. The technical standards to be developed in respect of the indirect contractual arrangements thus should avoid the definition of too detailed and complex requirements. In this context it needs to be taken into account that the contractual arrangements for indirect clearing still need to be developed. These will need to cover very complex legal issues, in particular adequate protection/segregation of assets and collateral as well as portation of contracts in the event of a default of a clearing member. Market participants which will have to rely on indirect clearing in order to comply with the CCP-clearing requirements, in

particular small or medium sized institutions thus are facing considerable challenges. The contractual arrangements for two non-clearing members enter into transactions which each other, but having different clearing members, need to be clarified.

Q8. The term “currency” used in item 24 d. should be replaced by “settlement currency”. The ESMA register should provide as much information as possible to describe the class of derivatives subject to the clearing obligation. This should generally include other elements used to describe relevant class of derivatives for TR-reporting purposes and also key structural, legal and financial features of the relevant class of derivatives, e.g. additional options types, specific payment structures and/or other legal/structural specifics. Ideally, each derivatives class subject to the clearing obligation would receive a unique identifier. This identifier could also be used for TR-reporting purposes. In addition, it could be considered to include generic examples for the various classes of derivatives.

Q10,11. The fact that a specific non-financial entity has become subject to the clearing obligation should be notified to all potential counterparties. The responsibility to determine whether a non-financial counterparty is subject to the clearing obligation cannot lie with the other counterparty but has to be the sole responsibility of the non-financial entity in question. Counterparties must be able to rely on information made public by ESMA or the information provided by the relevant non-financial counterparty. As regards the definition of derivative contracts objectively measurable as risk reducing and the criteria for setting the clearing threshold a definition of hedge accounting or hedging purposes in this context cannot be based on international accounting standards alone but must of course also cover other accounting standards.

Q12. The time limits proposed appear to be largely based on processes and timelines observed in transactions executed on futures and options exchanges or securities exchanges which cannot be directly transposed to OTC-derivative transactions. This applies in particular to transactions which are not clearing-eligible such as bespoke transactions. Here, the confirmation process is particularly time-consuming. The proposed time limits do also not sufficiently take into account the significant differences between the types of counterparties involved in these transactions which range from highly sophisticated to less sophisticated market participants. Less sophisticated market participants with a significantly lower amount of transactions will have more time consuming internal processes than more sophisticated ones and may have a significantly less developed technical infrastructure. The limited volume of transactions will for many smaller counterparties not merit electronic processing. In addition, it will also have to be taken into account that some transactions may be subject to a requirement to be confirmed in writing.

The meaning of confirmation, specifically the information to be covered, needs to be defined in order to avoid uncertainties and misconceptions. According to current practice and the

prevalent understanding of market participants the confirmation covers the key economic terms of the transaction and not the complete transactional documentation and all details of the transaction. Also it is common practice and essential to prevent inconsistencies, that the confirmation process is initiated by one party only and not independently by each of the parties. Thus, it should also be clarified that the time limits to be defined by the technical standards apply to the initiation of the confirmation process.

The time required for an electronic confirmation can differ considerably depending on the type of transaction and market participants involved. For example, confirmations concerning bulk transactions are significantly more time consuming than confirmations concerning single simple transactions. Likewise, less sophisticated market participants will have a significantly less developed infrastructure for the processing of transactions. It should be made sure that exceptions from the timing are possible when down-times of any of the involved electronic components occur. Small financial and non-financial counterparties with a limited range of derivative exposure should not be forced to implement and perform a confirmation process through electronic platforms. In any event, the benchmarks set by highly sophisticated market participants and in relation to simpler transactions should not set the standard for all confirmations. In view of the fact that the confirmation process differs significantly depending on the type of transaction and types of counterparties involved, it cannot be assumed that electronic confirmations can be effected generally and always significantly quicker than non-electronic ones.

The time limits proposed under item 38 a. to c. appear to be based on benchmarks set by highly sophisticated market participants and in relation to simple transactions and thus cannot be applied to all market participants and in relation to all types of transactions. Moreover, the timeline to process a transaction varies significantly depending on the number of parties involved in the confirmation process, of the type of counterparty and the platforms/systems involved. Current experience indicates that in many instances the time limits proposed in the discussion paper cannot be met by existing systems/processes. The ISDA Benchmark Survey 2011 demonstrated that the average processing time for transactions between highly sophisticated counterparties varied significantly, depending on the type of transaction involved. The average processing times manageable in the case of transactions involving less sophisticated counterparties will necessarily be even longer and more varied. Against this background, it would be more realistic and ensure a higher quality and efficiency of the confirmation process to have a limit of 24 hours in case of electronic execution/processing and of 120 hours in case of non-electronic processing/execution. Furthermore, time limits should be expressed in hours and not days in view of transaction counterparties residing in different time zones.

Q16. The suggested threshold for mandatory daily portfolio reconciliations under item 48 b. (300 transactions) is too low. Effective and efficient reconciliations can only be achieved with

a sufficiently sophisticated internal systems as well as the assistance of highly sophisticated infrastructure providers. Especially these infrastructure providers require a significantly higher number of transactions for effective and efficient mass reconciliation. In addition, portfolio compression of bilateral trades imposes very high and very demanding standards on valuation as well as risk parameter settings. Especially for smaller or less sophisticated market participants, the potential benefits from compression can be easily outweighed by the risks entailed. The threshold should therefore be set at not less than 10000 transactions – consisting of compression eligible products only – which is also the threshold proposed for higher margin periods of risk in CRR 2(2). The thresholds and time-limits proposed under item 48 b. would need to be adjusted accordingly. One possible approach could be to have weekly reconciliation in case of 5000+ transactions, monthly reconciliation in case of 1000 to 5000 transactions and annual or semi-annual reconciliation in case of less than 1000 transactions. It should also be taken into account that margin calls already serve as a backstop control mechanism for portfolios that do not add up. Moreover, portfolio reconciliation should not be required where the counterparties use adequate platforms /execution services for the execution of transactions which prevent inaccurate transaction records.

Q19. Yes, however, these mechanisms are not to be understood as an exhaustive/final list of permissible mechanisms and they are to be considered as possible alternatives and are not meant to be applied simultaneously to a great number of cases. A workable approach may be the definition of best practice standards . These best practice standards would need to be sufficiently flexible to allow application to/adoption by less sophisticated counterparties.

Q20. The thresholds for reporting proposed are too short and should be raised to at least one month/30m EUR. This would help the authorities to focus on the potentially serious/relevant developments.

Q50. A minimum percentage requirement for cash collateral is not necessary, as all variation margins are usually cash based and already fulfil their main function of protecting the CCP itself. Collateralisation requirements of CCPs can put a significant strain on liquidity of clearing members and their clients, in particular if a significant portion has to be provided in cash. Thus, clearing members and clients should generally have as much flexibility as possible. Consequently, if a minimum cash requirement were to be established, it has to be sufficiently low.

Q76. A requirement to have a timestamps may pose a considerable challenge to smaller/less sophisticated counterparties, at least where the timestamp has to set out the exact second of the trade execution/confirmation. Further complications arise where third parties are involved. Thus, the confirmation date and clearing date should generally be sufficient.

Should you have additional questions or comments, please do not hesitate to contact us.



European Association of Public Banks

– European Association of Public Banks and Funding Agencies AISBL –

Kind regards,

Two handwritten signatures in black ink. The signature on the left is 'Henning Schoppmann' and the one on the right is 'Boris Bartels'.

Henning Schoppmann
EAPB

Boris Bartels
EAPB

The European Association of Public Banks (EAPB) represents the interests of 40 public banks, funding agencies and associations of public banks throughout Europe, which together represent some 100 public financial institutions. The latter have a combined balance sheet total of about EUR 3,500 billion and represent about 190,000 employees, i.e. covering a European market share of approximately 15%.