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Comments of the Zentraler Kreditausschuss[1] on "CESR's Call for Evidence on the technical standards to identify and classify OTC derivative instruments for TREM"

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[1] The Zentraler Kreditausschuss (ZKA) is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks financial group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,300 banks.

The ZKA welcomes the opportunity to comment on CESR's considerations concerning the exchange of transaction reports on OTC derivatives. The scope of this Call for Evidence is exclusively limited to the question how the exchange of transaction reports on said OTC derivatives might take place. CESR has suggested to use the already existing Transaction Reporting Exchange Mechanism (TREM). Whilst under the Directive on Markets in Financial Instruments (MiFID) it is mandatory to report transactions executed in derivatives admitted to trading on a regulated market, there is only an limited number of Member States where transactions in (certain) OTC derivatives must be reported.

To our knowledge, the UK and Ireland are the only Member States where this is the case. However, it is worth noting that these Member States still lack any established standard operating procedures for such transaction reporting purposes. In fact there are plans to introduce such procedures in the near future. A closer examination shows that a lot of problems, resulting from the customised design of OTC derivatives, are still unresolved.In its Consultation Paper 08/16, the Financial Services Authority (FSA) comes to the conclusion that there are countless versions of OTC derivatives in the market (para 5.16). This is the reason why such derivatives do not lend themselves to standardisation and thus a reasonable reporting. As a matter of fact, the products which are currently being discussed lack any standard categorisation. Up to now, there was no need for this because generally these transactions are concluded on a bilateral level between the counterparties and usually see no subsequent sale (trading). The individual nature of these transactions is the whole purpose for these products. As a matter of fact, any standardisation is neither intended nor necessary from this point of view.

We feel that at this time, any discussion of a data exchange concerning OTC derivatives would be clearly premature. Our reservations are owed to the fact that only a limited number of Member States are just establishing reporting obligations for such derivatives. In our view, it would make more sense to initially implement these extended reporting obligations in the respective Member States. This ought to be followed by an analysis of any problems that ocurred with a view to draw further conclusions for a data exchange. One advantage of such an incremental approach would be that complications that will only become manifest during the practical implementation of the reporting obligations will not have any simultaneous impact on the data exchange. This would prevent respective subsequent errors and associated costs, - costs which, finally, would have to be borne by the industry.

The first step should be a common understanding about the criteria for categorising the OTC derivatives. The UK currently discusses certain critical aspects in respect of the product categorisation. In this regard, we would like to point out that reporting fields with free texts seem to be not practicable. Such an approach does not allow an automated analysis of reports. Hence, there are considerable doubts as to whether the actual goal – primarily the swift identification of insider transactions– would indeed be attainable.

The consideration to work with free texts is a clear indication of the fact that OTC derivatives do not lend themselves easily to categorisation. Yet, we feel that such categorisation is a *conditio sine qua non* for meaningful market supervision. First and foremost, an in-depth stock-taking exercise of the existing product categories and their respective specifications would be necessary so as to prepare a corresponding catalogue. This is the only way for guaranteeing that all market participants share the same understanding. Otherwise, such an approach could have potentially fatal consequences: Comparable products might be reported in different ways by different market participants. This would clearly thwart the goals of supervision and finally make them unachievable.

As long as this preliminary work has not seen any successful conclusion, we feel that any extension of the reporting obligation's scope and any data exchange would be clearly premature.

Should, notwithstanding the foregoing reservations, CESR nevertheless comes to the conclusion that there is an imminent need to facilitate the data exchange amongst interested supervisory authorities, it would have to be ensured that the costs for the TREM system's modification will be exclusively borne by the authorities involved in the data exchange. In our view there is no legal basis for a general cost allocation – which finally will have to be paid by all supervised entities across EU Member States. The MiFID only warrants data exchange concerning those transactions which fall under the reporting obligation in all Member States. If and when individual Member States decide to exceed this requirement, they have to bear the costs for such an undertaking themselves.
