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**Comment on "ESMA's Discussion Paper - Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories"**

12-03-19

Dear Sir or Madam,

Please find enclosed the German Banking Industry Committee's comment on ESMA's 'Discussion Paper - Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories'.

The German Banking Industry thanks the European Securities and Markets Authority (ESMA) for the invitation to comment on the discussion paper and welcomes the opportunity to provide input at this stage of the process.

We limit our responses to queries with particular relevance to our members and to key aspects and concerns. In some cases, our comment addresses issues covered by more than one question. In this case, the relevant queries have been combined and the response is to be understood to relate to these questions.

Yours faithfully,  
on behalf of the German Banking Industry Committee  
National Association of German Cooperative Banks



Gerhard Hofmann

by proxy



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# Response of the German Banking Industry Committee to the Discussion Paper - Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade

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Berlin, 19 March 2012

The **German Banking Industry Committee** 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 finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,200 banks.

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## ***I. Introduction***

The German Banking Industry Committee thanks the European Securities and Markets Authority (ESMA) for the invitation to comment on the discussion paper concerning the draft technical standards for the regulation on OTC derivatives, central counterparties and trade repositories (the Regulation) to be drafted by ESMA and welcomes the opportunity to provide input at this stage of the process.

We limit our responses to queries with particular relevance to our members and to key aspects and concerns. In some cases, our comments address issues covered by more than one question. In this case the relevant queries have been combined and the response is to be understood to relate to these questions.

## ***II. Responses to Individual Queries in the Discussion Paper***

### ***1. Contracts between third country entities having an effect within the EU***

***Q1: In your views, how should ESMA specify contracts that are considered to have a direct, substantial and foreseeable effect within the EU?***

The nominal currency or that of an underlying may be one indicator but cannot be the sole indicator for a substantial effect within the EU. The focus must be on the potential relevance of the indicators chosen as effective indicators for a noticeable impact on the systemic risks within the EU. In view of the overriding interest in internationally compatible regimes, we believe that all key aspects should be coordinated with the corresponding rules and regulations of other major jurisdictions (compare e.g. Sec 722 d) Dodd-Frank Wall Street Reform and Consumer Protection Act).

***Q2: In your views, how should ESMA specify cases where it is necessary or appropriate to prevent the evasion of any provision of EMIR for contracts entered into between counterparties located in a third country?***

A single transaction cannot serve as sufficiently conclusive evidence for an intention to evade the application of EMIR. Rather, such conclusion will need to be based on patterns evident in a series of transactions. To this end, it will be necessary to identify indicators which conclusively and demonstrably have a link to such an intention to evade.

### ***2. Indirect Clearing Arrangements***

***Q3: In your views, what should be the characteristics of these indirect contractual arrangements?***

Market participants currently already rely on various types of standardised contractual documentations (master agreements), including the ISDA Master Agreements, the European Master Agreement, the German Master Agreement for Financial Derivative Transactions and the French Master Agreement. These contractual documentations are generally accepted and/or recommended by trading or industry

organisations. 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.

In this connection it has to be taken into account that the contractual framework needs to be sufficiently transparent and also operationally manageable for all counterparties. In particular, non-financial counterparties face limits regarding the complexity of contractual arrangements, even more so, where this is subject to the laws of another jurisdiction.

The technical standards to be developed in respect of the indirect contractual arrangements thus should avoid the definition of too extensive / detailed complex and technical 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 following situation in the context of contractual arrangements needs to be clarified: two non-clearing members enter into transactions with each other, but having different clearing members.

### **3. Implementation of the clearing obligation**

**Q4: What are your views on the required information? Do you have specific recommendations of specific information useful for any of the criteria? Would you recommend considering other information?**

**Q5: For a reasonable assessment by ESMA on the basis of the information provided in the notification, what period of time should historical data cover?**

- Detailed/specific description of the class of derivatives

A class of derivatives to be determined by ESMA as clearing eligible needs to be defined as clearly as possible. In no case should the class of derivatives be defined broader than the class cleared by the CCP whose competent authority notified ESMA. Such broad/general definitions may otherwise capture types of transaction which bear only some general similarities with the transaction types for which clearing is offered, but differ otherwise and thus may in fact not be accepted for clearing by the specific CCP (nor by others). This would effectively result in a ban of these specific OTC derivative transactions. Even if not defined broader as by the CCP, this could have the effect that market participants are forced to use this specific CCP. Consequently, CCPs requesting authorisations from their competent authorities should be obligated to provide as much detailed information on / and indicators for describing the relevant "class" of

derivatives for which they request authorisation. This would put EMSA (in its test for eligibility) in position to identify the class of derivatives that becomes subject to the clearing obligation as precisely as possible.

- Additional information

Furthermore, it should be considered to request information on other factors not directly related to the definition of the relevant class of derivatives, such as

- the adequacy/effectiveness of the risk mitigation instruments, and
- the infrastructure available to clearing members and clients of clearing members, in particular regarding the accounts (omnibus accounts and/or accounts in individual segregated accounts).

Although these factors are taken into account in connection with the authorisation of a CCP, they should also be taken into consideration with regard to the decision on imposing a clearing obligation as these factors can be crucial for market participants having to comply with the clearing obligation: For example, investment funds respectively investment management companies may be prevented under applicable law from using CCPs which do not offer sufficient segregation. For these, a clearing obligation on types of transactions which are only accepted by a CCP with an infrastructure which may be sufficient for obtaining authorisation but which does not meet the requirements existing under other applicable laws and regulations, would effectively constitute a ban of the transactions in question.

- Availability of information

Some of the information proposed, e.g. tightness of spreads might not be readily available.

- Phasing-in

In general, any determination of a clearing-obligation should provide for an adequate phasing-in period. The length and structuring of this phasing-in period needs to take into account the considerable challenges all counterparties are facing (which will always include smaller/less sophisticated counterparties) in connection with the practical and technical implementation of the obligation, including the establishment of new or adjustment of existing systems required for CCP-clearing.

As to the manner in which the phasing-in period should be structured, see response to Q9 (not only to be restricted to types of counterparties).

#### ***Q6: What are your views on the review process following a negative assessment?***

First, in the interest of certainty and transparency, negative assessments should be published by ESMA.

There should be a minimum waiting period of at least one year following a negative assessment for resubmission of a notification. This is not only to mitigate the workload of ESMA, but also the considerable administrative processes associated with a new assessment by other market participants. E.g. if a derivative class is in the evaluation phase, market participants will have to begin to assess the operational challenges to be expected and initiate the necessary preparations. If re-submissions were

permissible immediately after a negative assessment, market participants would be forced to make these operational assessments continuously. This would clearly be an unreasonable burden.

**Q7: What are your views regarding the specifications for assessing standardisation, volume and liquidity, availability of pricing information?**

- Standardisation of contractual documentation (item 22 a.)

One key element should be the use of contractual terms contained in or corresponding to those used in master agreements. The above comments under Q 3 regarding the use of master agreements as effective and risk mitigating instruments, and the need that market participants have the ability to select the type of master agreement best suited to their needs as well as operational capabilities, and which best ensures compliance with applicable legal/regulatory requirements apply correspondingly.

The standardisation requirements regarding the contractual terms/documentation thus have to be defined open enough to cover contractual terms based on all accepted types of master agreements. They also have to be neutral as regards the applicable language as well as law/jurisdiction.

CCPs and service providers should not be able to restrict access or limit any functions/services which counterparties depend upon in order to comply with the obligations under the Regulation or any Technical Standard in relation thereto solely on the basis of the contract language, applicable law/jurisdiction or contractual terms used by market participants.

- Proportionality of margins and historical stability of liquidity (item 22 b.)
- Accessibility of pricing information (item 22 c.)

CCP clearing is only possible with a sufficient degree of liquidity / sufficiently high trade volume. The thresholds to be set in this respect should therefore include a sufficient safety margin.

Liquidity is of utmost importance. In view of the fact that liquidity is also referred to in other regulatory areas (e.g. MiFID/MIFIR, CRD IV), and that the concept of liquidity may differ considerably depending on the context and circumstances, the technical standards will need to include definition of the concept of liquidity addressing the specific situation of CCPs.

Liquidity can only be defined by a combination of factors. The number of transactions entered into within a certain period of time is certainly an important indicator but is of course not the single /decisive factor. Other factors include, but are not limited to the number/types of counterparties active.

Different types of transactions may also require different liquidity levels.

**Specifics regarding covered bonds**

In assessing the criteria for the clearing obligation, ESMA should also take into account the very specific issue of derivatives as risk mitigation instruments for the management of covered bonds. We welcome that the legislators explicitly address these problems faced by covered bonds issuers: In recital 12, ESMA is thus invited "(...) to take into account the specific nature of OTC derivatives which are concluded with covered bond issuers or with cover pools for covered bonds."

Covered bonds are dual recourse debt instruments issued by credit institutions (the covered bond issuer) and secured by a cover pool, typically composed of mortgage loans or public-sector debt. Almost all European Member States have covered bond legal frameworks that allow derivatives in the cover pool with the purpose of hedging risk, such as interest rate risk or currency mismatches, as long as these “cover derivatives” are designed to survive the issuer’s insolvency. It is in the case of the issuer’s insolvency that the covered bond investors need the hedging effect of cover derivatives in order to minimise risks of the cover pool. Hence, common master agreements are adapted or supplemented in order to fulfil the legal requirement that the insolvency of the issuer does not qualify the counterparty to terminate the derivative contract.

Covered bond issuers have approached CCPs in order to discuss whether cover derivatives could be cleared through CCPs. However, at present, CCPs are technically unable to differentiate between the derivative contracts of the insolvent issuing bank and those of the covered bond cover pool. The CCP would simply settle the accounts of the insolvent bank. This means that cover derivatives are unable to be cleared through a CCP and are unlikely to be able to be so for the foreseeable future.

Another issue in certain jurisdictions is that legal provisions call for unilateral collateral posting, i.e. the issuer or cover pool never posts collateral whereas the derivative counterparty does when required. The reasons for this are the legal requirements that the claim of the derivative counterparty must be covered by the cover pool assets and that the counterparty ranks *pari passu* with covered bond holders.

Hence, we ask ESMA to consider, that at first glance, the respective interest or currency swaps for the cover pool may appear to be clearing eligible. However, CCPs would not technically be able to clear the contracts because the master agreements used as contractual basis for the transactions contain provisions implementing the bankruptcy remoteness clause or unilateral collateral posting called for in the existing legal requirements.

***Q8: What are your views, regarding the details to be included in ESMA Register of classes of derivatives subject to the clearing obligation (Article 4b)?***

To avoid uncertainties and confusion, 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 (not counterparty specific information or relating to the specific economic terms of the transaction) 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 (upfront/backend payments) and/or other legal/structural specifics (which may follow from the contractual documentation on the basis of which the counterparties entered into the transaction, such as the ISDA Master Agreement, German Master Agreement for Financial Derivative Transactions, European Master Agreement).

Ideally, each derivatives class subject to the clearing obligation would receive a unique identifier (similar to the ISIN and to be published by EMSA on its website). 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 (in form of a non-exhaustive list of typical elements contained in a contract in respect of this class of derivatives), such as:

- Typical reference entities
- Regarding Interest rate swaps (IRS): money- and capital market rates (e.g. LIBOR, Euribor)
- Regarding Index CDS: Indices used (e.g. iTraxx, CDX)

***Q9: Do you consider that the data above sufficiently identify a class of derivatives subject to the clearing obligation and the CCPs authorised or recognised to clear the classes of derivatives subject to the clearing obligation?***

We have no comments regarding the information required for the identification of the CCPs.

As to the details regarding the timeline for the coming into force of the clearing obligation, we note that item 26 only mentions phasing-in in relation to types of counterparties. It should, however, also be considered to provide for a step by step phasing-in based on other criteria than the counterparty (such as sub-classes of products or threshold amounts etc.) in order to allow a more structured initiation of the clearing for a product class.

In addition, in this context, specific phasing-in provisions should be developed in respect of transactions to which the clearing obligation applies retroactively (transactions entered into before the determination of a clearing obligation).

#### **4. Non Financial Counterparties**

***Q10: In your view, does the above definition appropriately capture the derivative contracts that are objectively measurable as reducing risk directly related to the commercial or treasury financing activity?***

***Q11: In your views, do the above considerations allow an appropriate setting of the clearing threshold or should other criteria be considered? In particular, do you agree that the broad definition of the activity directly reducing commercial risks or treasury financing activity balances a clearing threshold set at a low level?***

In the interest of legal certainty, the fact that a specific non-financial entity has become subject to the clearing obligation should be notified to all potential counterparties, e.g. by listing the identity (where possible by LEI) of the relevant non-financial entities in the register maintained by ESMA.

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, in the event such list would not be maintained, the information provided by the relevant non-financial counterparty (e.g. a statement by the relevant counterparty that it is not subject to the clearing obligation has to be sufficient).



As regards the definition of derivative contracts objectively measurable as risk reducing (Q10) and the criteria for setting the clearing threshold we confine ourselves to the general observation that - in particular in the interest of small and medium sized entities - 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 (e.g. IFRS or national standards).

## **5. Risk mitigation for bilateral transactions**

**Q12: What are your views regarding the timing for the confirmation and the differentiating criteria? Is a transaction that is electronically executed, electronically processed or electronically confirmed generally able to be confirmed more quickly than one that is not?**

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 (for example hedging transactions structured to meet the specific demands of a counterparty). 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.

This affects all aspect addressed by Q12:

- Definition/scope of the confirmation

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 also 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 – that is, the first sending of the confirmation by one of the counterparties and not the receipt of a counter-confirmation/affirmation/acknowledgment by the other counterparty or the matching.

- Electronic- and non-electronic confirmation

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 (which would include a significant portion of market participants

falling under the definition of financial counterparty in particular small and medium sized banks) will have a significantly less developed infrastructure (human resources, system capacity) for the processing of transactions. and thus will generally require more time for processing 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 (electronic or non-electronic).

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.

- Proposed time limits for timely confirmation (items 38 a. to c.):

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 (in particular bespoke 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 (financial or non-financial) and the platforms/systems involved (e.g. novation process). 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, the following limits would be more realistic and ensure a higher quality and efficiency of the confirmation process:

- Electronic execution/electronic processing: 24 hours (time limits should be expressed in hours and not days in view of transaction counterparties residing in different time zones)
- Non-electronic processing/execution: 120 hours (= 5 days)

***Q13: What period of time should we consider for reporting unconfirmed OTC derivatives to the competent authorities?***

- Definition/meaning of outstanding/unconfirmed:

The terms outstanding and/or unconfirmed transactions need to be clearly defined as follows:

- Outstanding transactions: Encompasses unconfirmed transactions as well as confirmed transactions for which the reporting party has not yet received a (counter) confirmation from the counterparty and/or which have not yet been matched/executed.
- Unconfirmed transactions: From the perspective of the reporting entity, transactions for which no trade confirmation has been issued by the relevant party and/or received from the counterparty.

As to the understanding/definition of “confirmation” (key economic terms), see response to Q12 above.

- Timeline for reporting:

A period of more than 30 days (to avoid misunderstandings better to be expressed as: trade day + 30 calendar days) appears to be appropriate. However, market participants should be permitted to make the reports in batches (e.g. per asset class). The relevant reports should be made once per month in respect of unconfirmed transactions in the preceding month. As in the case of the time lines addressed in Q12, it needs to be taken into account that the benchmarks set by highly sophisticated counterparties cannot be applied to all market participants and across all asset classes. Adequate time limits allowing the counterparties to assess the volume of unconfirmed transactions with sufficient certainty will greatly increase the efficiency of the processes and the accuracy of the data received by competent authorities.

***Q14: In your views, is the definition of market conditions preventing marking-to-market complete? How should European accounting rules be used for this purpose?***

To avoid uncertainties, it should be considered to provide for a definition of the term “inactive market” (e.g. no price or turnover for the past 2 days). Please also see below our response to Q15.

***Q15: Do you think additional criteria for marking-to-model should be added?***

Mark-to-model is a standard process applied to many liquid OTC derivatives for which prices are not delivered on a daily basis due to individual conditions such as the maturity. For these instruments market interest rates or exchange rates are used to feed standard models used in the market to get a pricing for them. The definition of “inactive market” should cover this practice. Alternatively, it could be considered to add an additional criterion addressing this specific aspect.

***Q16: What are your views regarding the frequency of the reconciliation? What should be the size of the portfolio for each reconciliation frequency?***

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 (i.e. valuation errors and not or poorly specified risk parameters).

In view of the above, 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 para 2.

The thresholds and time-limits proposed under item 48 b. would need to be adjusted accordingly. One possible approach could be as follows:

- 5000+ transactions: weekly reconciliation
- 1000 to 5000 transactions: monthly reconciliation
- Less than 1000 transactions (generally involving less sophisticated market participants): annual or semi-annual reconciliation (in particular in these cases the counterparties require sufficient time for the generally very time-consuming resolution of any discrepancies)

In this connection 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.

***Q17: What are your views regarding the threshold to mandate portfolio compression and the frequency for performing portfolio compression?***

Portfolio compression cannot be achieved in relation to a significant portion of bilateral transactions, in particular in respect of more complex non-standardised transactions. Thus, portfolio compression can only be mandated in respect of transactions eligible for compression. Consequently, the scope of any mandatory requirement to provide for portfolio compression needs to be defined accordingly.

Portfolio compression, even more so than portfolio reconciliation, requires a highly complex and sophisticated infrastructure (internal as well as external) which again means that effective and efficient portfolio compression can only be effected with sufficiently large transaction basis. Against this background, the number proposed in the discussion paper appears to be extremely low. The transaction threshold for transactions eligible for compression should therefore be raised significantly (to not less than 10000 transactions).

Likewise, the frequency (twice per year) is not suitable or feasible in all circumstances and for all counterparties alike. Even where the relevant service providers may offer compression services for eligible transactions, a participation in the relevant process may not be warranted due to the small number of transactions involved. Thus, counterparties should not be subject to an obligation to take part in every single compression process offered.

It should also be taken into account that some market participants may only have significant portfolios in some asset classes (e.g. only in respect of interest rate derivatives). Thus, a more flexible approach avoiding too rigid/formal requirements would enable market participants to adjust their processes better to their specific circumstances and make processes more efficient.

Mandatory portfolio compression may conflict with accounting requirements, in particular national accounting rules applied by smaller institutions and non-financial counterparties. Where this is the case, the counterparties will need an exemption or at least a transition period.

***Q18: What are your views regarding the procedure counterparties shall have in place for resolving disputes?***

The requirements will affect internal/operational processes as well as the contractual/legal framework (in particular issues addressed under item 54 c.). When defining requirements regarding the legal/contractual framework for dispute resolution mechanisms, the focus should not be on the level of detail but rather on the efficiency and (legal) effectiveness of the provisions. The master agreements currently in use (e.g. the ISDA Collateral Support Annex and the Collateral Annex to the German Master Agreement for Derivative Transactions ("Besicherungsanhang")) already contain provisions concerning dispute resolution, which have generally proven to be very effective. The solutions provided in the different types of master agreements may differ to some extent, in particular as to their level of complexity. However, such differences reflect the fact that many market participants may prefer simpler solutions in view of their available resources and operational infrastructure. The requirements should therefore not prescribe any specific combinations of instruments and allow a broader choice of solutions, including simple yet effective solutions.

The proposed timeframe (5 days) is too rigid. Especially in the case of more complex issues too much time pressure may prove to be counterproductive. A time limit of 15 days would appear to be more realistic.

***Q19: Do you consider that legal settlement, third party arbitration and/or a market polling mechanism are sufficient to manage disputes?***

Yes, however, subject to the following:

- These mechanisms are not to be understood as an exhaustive/final list of permissible mechanisms and they are to be considered as possible alternatives (no obligation to provide for these cumulatively).
- These mechanisms are not meant to be applied simultaneously to a great number of cases.

A workable approach may be the definition of "best practice" standards (as opposed to mandatory/rigid minimum thresholds). These best practice standards would need to be sufficiently flexible to allow application to/adoption by less sophisticated counterparties.

***Q20: What are your views regarding the thresholds to report a dispute to the competent authority?***

The thresholds for reporting proposed are too short and should be raised to at least 1 month/30m EUR. This would help the authorities to focus on the potentially serious/relevant developments.

***Q21: In your views, what are the details of the intragroup transactions that should be included in the notifications to the competent authority?***

***Q22: In your views what details of the intragroup transactions should be included in the information to be publicly disclosed by counterparty of exempted intragroup transactions?***

As notifications should be in respect of the entities as such and cover all future transactions between the entities having been notified (as opposed to a new notification on the occasion of each transaction), the only information of relevance to the markets is the name/identity of the entities in question falling under the intra-group exemption. Consequently, information on the individual transactions should and could in this context not be provided. There is no discernable need for any further disclosure of information to the public, in particular against the background of reporting obligations to trade repositories. In any case, it cannot be the objective of the Regulation to impose a disclosure obligation in respect of intragroup transactions which, in effect, would give insight into the respective institution's internal treasury and other highly sensitive information.

In the interest of efficiency, it should be permissible that the relevant notifications are made by one group entity on behalf of all group members.

## **6. CCP Requirements**

***Q23: What are your views on the notion of liquidity fragmentation?***

***Q24: What are your views on the possible requirements that CCP governance arrangements should specify? In particular, what is your view on the need to clearly name a chief risk officer, a chief technology officer and a chief compliance officer?***

***Q25: Are potential conflicts of interests inherent to the organisation of CCPs appropriately addressed?***

***Q26: Do the reporting lines – as required – appropriately complement the organisation of the CCP so as to promote its sound and prudent management?***

***Q27: Do the criteria to be applied in the CCP remuneration policy promote sound and prudent risk management? Which additional criteria should be applied, in particular for risk managers, senior management and board members?***

***Q28: What are your views on the possible organisational requirements described above? What are the potential costs involved for implementing such requirements?***

***Q29: Should a principle of full disclosure to the public of all information necessary to be able to understand whether and how the CCP meets its legal obligations be included in the RTS? If yes, which should be the exceptions of such disclosure requirements? Has the information CCP should disclose to clearing members been appropriately identified? Should clients, when known by the CCP, receive the same level of information?***

***Q30: What are your views on the possible records CCPs might be required to maintain?***

***Q31: What are your view on the modality for maintaining and making available the above records? How does the modality of maintaining and making available the records impact the costs of record keeping?***

**Q32: What are your views on the possible requirements for the business continuity and disaster recovery plan and in particular on the requirements for the secondary site? Would it be appropriate to mandate the establishment of a third processing site, at least when the conditions described above apply? What are the potential costs and time necessary for the establishment of a third processing site and for immediate access to a secondary business site?**

**Q33: Is the 2 hours maximum recovery time for critical functions a proportionate requirement? What are the potential costs associated with that requirement?**

**Q34: Are the criteria outlined above appropriate to ensure that the adequate percentage above 99 per cent is applied in CCP's margin models? Should a criteria based approach be complemented by an approach based on fixed percentages? If so, which percentages should be mandated and for which instruments?**

Regarding Q34: When defining an appropriate confidence interval, consideration should be given to its implications on the rules of portability in a way that clearing members do not refrain from taking the position as a back up-clearer.

**Q35: Taking into account both the avoidance of procyclicality effects and the need to ensure a balance distribution of the financial resources at the CCP disposal, what it is in your view the preferred option for the calculation of the lookback period.**

**Q36: Is in your view the approach described above for the calculation of the liquidation period the appropriate one? Should a table with the exact number of days be included in the technical standards? Should other criteria for determining the liquidation period be considered?**

**Q37: Is procyclicality duly taken into account in the definition of the margin requirements?**

**Q39: Do you believe that the elements outlined above would rightly outline the framework for managing CCPs' liquidity risk?**

**Q40: Do you consider that the liquid financial resources have been rightly identified? Should ESMA consider other type of assets, such as time deposits or money market funds? If so, please provide evidences of their liquidity and minimum market and credit risk.**

**Q41: Should the CCP maintain a minimum amount of liquid assets in cash? If so, how this minimum should be calculated?**

**Q42: What is your preferred option for the determination of the quantum of dedicated own resources of CCPs in the default waterfall? What is the appropriate percentage for the chosen option? Should in option a, the margins or the default fund have a different weight, if so how? Should different criteria or a combination of the above criteria be considered?**



***Q43: What should be the appropriate frequency of calculation and adaptation of the skin in the game?***

No comment

***Q44: Do you consider that financial instruments which are highly liquid have been rightly identified? Should ESMA consider other elements in defining highly liquid collateral in respect of cash of financial instruments? Do you consider that the bank guarantees or gold which is highly liquid has been rightly identified? Should ESMA consider other elements in defining highly liquid collateral in respect of bank guarantees or gold?***

***Q45: In respect of the proposed criteria regarding a CCP not accepting as collateral financial instruments issued by the clearing member seeking to lodge those financial instruments, is it appropriate to accept covered bonds as collateral issued by the clearing member?***

***Q46: Do you consider that the proposed criteria regarding the currency of cash, financial instruments or bank guarantees accepted by a CCP have been rightly identified in the context of defining highly liquid collateral? Should ESMA consider other elements in defining the currency of cash, financial instruments or bank guarantees accepted by a CCP as collateral? Please justify your answer.***

We thoroughly believe that CCPs should not be forced to accept any collateral deemed "liquid" by the standards established, but rather should be offered the choice to do so. We do agree that certain minimum conditions should be set. But CCPs, especially after seeking advice from their risk committees, should be able to decide on their own which assets to accept as collateral. The collateral policy implemented by a CCP thus complements the minimum requirements defined by the technical standards, thereby establishing a double safety net.

The proposed definition of "highly liquid" appears to be very similar to that in the CRR regarding the liquidity coverage ratio. While we would welcome very much a single and comprehensive definition of "highly liquid" we do see some potential unintended consequences in this regard. EMIR as well as the CRR (and at least the reporting phase of the LCR and with this also to some extent the quantitative requirement due to market pressure) are both intended to become binding rules as of the beginning of 2013. This can have the effect that a great number of market participants will be attempting to get a hold of the same type of assets not only for the LCR but also to cover collateral needs with CCPs. The IMF has figured that the overall volume for CCP collateral alone amounts to roundabout USD 2 trillion. Given that the total amount of eligible assets is limited to a certain extent, this demand may result in significant market distortions and serious unforeseeable consequences.

In view of the risks clearing members have to bear, market participants will be reluctant to become clearing members of any CCP with insufficiently robust risk mitigation structures (including collateral standards). Therefore, the market will assist the competent authorities in identifying CCPs with insufficiently robust collateral standards.

For the same reasons ESMA should be hesitant to declare eligible a class of derivatives that is only cleared by a CCP with a limited member base at least until a CCP deemed more robust by market participants offers clearing.



We welcome the fact that the discussion paper (item 124) expressly proposes to allow CCPs to accept covered bonds issued by the clearing member as collateral (subject to certain requirements): Covered bonds are incorporating a claim against the issuer in the first place and additionally offer full recourse to a cover pool of high quality assets. A cover pool is a clearly identified, “ring-fenced” pool of assets dedicated to secure the covered bonds. We understand the restrictive conditions proposed by CPSS-IOSCO that way that the cover assets must be appropriately segregated from the other issuer’s assets in the case of the issuer’s insolvency. In this connection it should be clarified that it is the covered bond itself which has to comply with the requirements for acceptable collateral, and not the cover assets.

***Q47: Do you consider that the elements outlined above would rightly outline the framework for determining haircuts? Should ESMA consider other elements?***

***Q48: Do you believe that the elements outlined above would rightly outline the framework for assessing the adequacy of its haircuts? Should ESMA consider other elements?***

***Q49: Do you consider that the elements outlined above would rightly outline the framework for determining concentration limits? Should ESMA consider other elements?***

***Q50: Should a CCP require that a minimum percentage of collateral received from a clearing member is provided in the form of cash? If yes, what factors should ESMA take into account in defining that minimum percentage? What would be the potential costs of that requirement?***

We do not believe a minimum percentage requirement for cash collateral to be necessary. As all Variation Margins are usually cash based and these 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.

***Q51: Do you consider that financial instruments and cash equivalent financial instruments which are highly liquid with minimal market and credit risk have been rightly identified? Should ESMA consider other elements in defining highly liquid financial instruments with minimal market and credit risk? What should be the timeframe for the maximum average duration of debt instrument investments?***

We believe that covered bonds should be defined as a highly liquid financial instrument under the RTS for Investment Policy as these can be considered to pose minimal market risks provided that they meet the requirements outlined under item 135 1) (i) to (vi) of the discussion paper (that is with the exception of the requirements under item 135 (vii) a) to b): debt instrument issued or guaranteed by a government, central bank or multilateral development bank).

Covered bonds should be given a greater level of recognition that fully reflects their safety, liquidity and resilience in times of stress, as witnessed during the recent crisis (see *European Covered Bond Council Factbook 2011*). Covered bonds offer a dual recourse to both the issuing bank and a well defined pool of

high quality assets and exhibit a close performance with government bonds, for example, in terms of credit quality. Furthermore, the asset class is regulated by law, is subject to specific supervision and has continued to attract a broad and stable investor base.

***Q52: Do you think there should be limits on the amount of cash placed on an unsecured basis?***

No comment.

***Q53: Do you consider that CCP should be allowed to invest in derivatives for hedging purposes? If so, under which conditions and limitations.***

Yes. Derivative transactions will not only be necessary in connection with addressing default scenarios but also other risk scenarios to which the CCP may be exposed in the course of ordinary business (such as interest rate and foreign exchange rate related developments). A general restriction allowing derivative transactions only in very limited circumstances and only in connection with addressing a default situation may thus impede the efficiency of the risk management of the CCP.

Derivative transactions which objectively serve risk mitigation (hedging) purposes should therefore be permissible subject to clear guidelines and supervision by the regulatory authority. The criteria applied to identify derivative transactions serving hedging purposes in connection with the provision regarding the clearing threshold for non-financial entities could generally be applied correspondingly in relation to CCPs in order to identify such permissible transactions. Also, the CCP should be required to adopt a policy on derivative transactions for hedging purposes subject to review and the consent of the risk committee of the CCP.

***Q54: Do you consider that the proposed criteria regarding the currency of financial instruments in which a CCP invests has been rightly identified in the context of defining highly liquid financial instruments with minimal market and credit risk? Should ESMA consider other elements in defining the currency of highly liquid financial instruments with minimal market and credit risk? Please justify your answer.***

We concur with the proposal regarding the three criteria for permissible currencies under items 138 (i) to (iii) which – as we understand it – apply alternatively and not cumulatively.

***Q55: Do you consider that the elements outlined above would rightly outline the framework for determining the highly secured arrangements in respect of which financial instruments lodged by clearing members should be deposited? Should ESMA consider other elements? Please justify your answer.***

***Q56: Do you consider that the elements outlined above would rightly outline the appropriate framework for determining concentration limits? Should ESMA consider other elements? Please justify your answer.***

***Q57: What are your views on the definitions of back and stress testing?***

***Q58: What are your views on the possible requirements for a CCP's validation process?***

**Q59: What are your views on the possible back testing requirements?**

**Q60: Would it be appropriate to mandate the disclosure of back testing results and analysis to clients if they request to see such information?**

A disclosure of backtesting results upon request may be useful to increase transparency on the model and its parameters.

**Q61: Should the time horizons for back tests specified under 144(e) be more granular? If so, what should the minimum time horizon be? Should this be different for different classes of financial instruments?**

**Q62: What are your views on the possible stress testing requirements?**

**Q63: Would it be appropriate to mandate the disclosure of stress testing results and analysis to clients if they request to see such information?**

A disclosure of stresstesting results upon request may be useful to increase transparency on the model and its parameters.

**Q64: What are your views on the possible requirements for reverse stress tests? And what impact do you think such requirements would have on industry?**

**Q65: Should there be any other parties involved in the definition and review of tests? Please justify your answer and explain the extent to which suggested parties should be involved?**

**Q66: Should the testing of default procedures involve a simulation process?**

**Q67: Are the frequencies specified above appropriate? If no, please justify your answer.**

**Q68: In your view what key information regarding CCP risk management models and assumptions adopted to perform stress tests should be publicly disclosed?**

No comment.

## **7. Trade Repositories**

**Q69: What is your view on the need to ensure consistency between different transaction reporting mechanisms and the best ways to address it, having in mind any specific items to be reported where particular challenges could be anticipated?**

To ensure the greatest possible efficiency of the processes as well as the accuracy/quality of the information reported, the key objective has to be the prevention of parallel/multiple reporting (TR-reporting or other reporting requirements) concerning identical or nearly identical information. Market

participants should be able to discharge their reporting obligations in respect of a transaction by making one single report. Parallel reports (e.g. to more than one TR if the TR reporting requirements are not sufficiently coordinated or to a TR as well as regulatory authorities) need to be avoided as these will result in inaccuracies and inefficiencies. To this end,

- format/requirements regarding the content of the information to be provided under all existing reporting requirements in respect of transactions should be aligned and
- terms identifying reportable elements of information need to be used/defined consistently

so that the market participants can combine these reporting obligations (at least as far as possible).

Wherever possible, definitions used and requirements laid down in respect of the information to be reported and the reporting formats should conform with corresponding definitions and format-requirements under currently existing reporting requirements, in particular Art. 25 (3) MiFID in connection with Art. 13 (1) and Annex I, Table 1 of Regulation (EC) No. 1287/2006 in order to avoid redundant multiple reporting or even inconsistent or conflicting information in respect of the same transaction.

***Q70: Are the possible fields included in the attached table, under Parties to the Contract, sufficient to accurately identify counterparties for the purposes listed above? What other fields or formats could be considered?***

We believe that the fields in table 1 of Annex II are generally sufficient.

However, descriptions of features should be as neutral/open as possible in order to cover all existing market practices. For example, XXX/360 may not cover all existing day count conventions such as Act/Act ISDA, Act/365 or Act/Act ISMA).

***Q71: How should beneficiaries be identified for the purpose of reporting to a TR, notably in the case of long chains of beneficiaries?***

The rules/definitions regarding the recording/reporting of beneficiaries applicable under Art. 10 para 1 of the Transparency Directive (2004/109/EG) should be applied correspondingly to avoid conflicting/inconsistent information.

***Q72: What are the main challenges and possible solutions associated to counterparty codes? Do you consider that a better identifier than a client code could be used for the purpose of identifying individuals?***

The key objective should be the prevention of conflicting information. Currently the most efficient and precise method is the client identifier under MiFID (Art. 23 (3) of the future MiFIR). The LEI is an equally precise method, where applicable. Thus, where a code/identifier (LEI, client identifier,) is available no other/further information should be added.

***Q73: What taxonomy and codes should be used for identifying derivatives products when reporting to TRs, particularly as regards commodities or other assets for which ISIN cannot be used? In which circumstances should baskets be flagged as such, or***

***should their composition be identified as well and how? Is there any particular aspect to be considered as regards a possible UPI?***

We concur with the assessment set out under item 182 of the discussion paper that the responsibility for the development of a functioning taxonomy primarily lies with the industry and that ESMA will only take subsidiary action. A taxonomy based on industry initiatives should generally ensure an internationally accepted system which is sufficiently efficient and flexible to cover all products.

Starting point for any taxonomy will be a general classification based on the type of underlying /asset class involved which will then be complemented by further general characteristics.

However, we believe that at least initially, the level of granularity should not be too fine. The degree of differentiation and granularity should increase organically over time.

One challenge may be that the evolving system of taxonomy needs be broad enough to cover transactions entered into on the basis of different types of contractual documentations (master agreements) as well as contract languages. This may be an area where ESMA may have to review developments closely to ensure that the taxonomy is not inadvertently resulting in limitations or restrictions which may impede an efficient reporting of all transactions.

In this context consideration might be given to ISO 10962 - Classification of Financial Instruments.

***Q74: How complex would be for counterparties to agree on a trade ID to be communicated to the TR for bilaterally executed transactions? If such a procedure is unfeasible, what would the best solution be to generate the trade ID?***

The trade ID needs to be allocated centrally to avoid conflicts. The entities best suited for this purpose are the market infrastructure providers involved, including the TRs/confirmation matching service providers.

***Q75: Would information about fees incorporated into pricing of trades be feasible to extract, in your view?***

We believe this is not necessary. It would also be an extremely challenging requirement as it will not be possible to circumscribe the scope of fees to be captured in this context with sufficient clarity.

***Q76: What is your view of the granularity level of the information to be requested under these fields and in particular the format as suggested in the attached table?***

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 (brokers etc.) are involved. Thus, the confirmation date and clearing date should generally be sufficient (in particular in the case of bilateral transactions).

***Q77: Are the elements in the attached table appropriate in number and scope for each of these classes? Would there be any additional class-specific elements that should be considered, particularly as regards credit, equity and commodity***

***derivatives? As regards format, comments are welcome on the possible codes listed in the table.***

We believe the elements proposed in Annex II, table 1 sections 2c and 2g are generally appropriate/sufficient.

In this context we do however reiterate our call for global harmonisation in view of the international nature of the markets and the fact that the competent authorities will need to assess aggregated data from many TRs potentially subject to other jurisdictions in order to get a comprehensive overview over the markets.

***Q78: Given that daily mark-to-market valuations are required to be calculated by counterparties under [Article 6/8] of EMIR, how complex would it be to report data on exposures and how could this be made possible, particularly in the case of bilateral trades, and in which implementation timeline? Would the same arguments also apply to the reporting of collateral?***

The information involved is extremely complex and any reporting thereof will be very challenging. The information would also be extremely sensitive. We therefore strongly suggest reconsidering any reporting obligation in this respect.

***Q79: Do you agree with this proposed approach? What are in your view the main challenges in third party reporting and the best ways to address them?***

We agree with the approach, and in particular support the emphasis put on protection of data. However, to avoid any uncertainties, it needs to be clarified that the protection of data must extend to protection of economic data (specifically the identity of the contractual parties and specific commercial terms of the transaction) and is not restricted to personal data. The economic data reported is extremely sensitive and any misuse can result in far reaching and severe consequences.

***Q80: Do you envisage any issues in providing the information/documentation as outlined above? In particular:***

***a) what would the appropriate timeline over which ESMA should be requesting business plans (e.g. 1, 3, 5 years?)***

***b) what would the appropriate and prudent length of time for which a TR must have sufficient financial resources enabling it to cover its operating costs (e.g. 6 months / 1 year)?***

***Q81: What is your view on these concerns and the ways proposed to address them? Would there be any other concerns to be addressed under the application for registration and tools that could be used?***

No comment.

***Q82: What level of aggregation should be considered for data being disclosed to the public?***

In view of the sensitive nature of the economic data involved (see our response to Q79 above) only the competent supervisory authority should have access to data on individual derivative contracts, or data which allows insight into the identity of the contractual parties and specific commercial terms of the transaction.

Yet even with regard to data accessible by regulators, existing legal restrictions need to be observed. In particular, all limitations under applicable data protection and privacy laws regarding the transfer of data, especially any personal data, across jurisdictional borders need to be respected. Because of the highly sensitive nature of the commercial details of a transaction, the protection of business secrets and proprietary information needs to be safeguarded as well against any misuse.

Serious concerns would arise if infrastructure providers, market participants, or the general public were to obtain access to detailed data on individual transactions. Consequently, access by any other party than the competent supervisory authorities needs to be limited to aggregate data (on a regular basis). Such aggregate data should not contain any sensitive commercial or personal data (even in aggregated form). The market participants should only have full access to their own transaction data and the aggregate data made available to the general public.

***Q83: What should the frequency of public disclosure be (weekly? monthly?); and should it vary depending on the class of derivatives or liquidity impact concerns; if yes, how?***

No comment.