Finanzgruppe
Deutscher Sparkassen- und Giroverband

Deutscher Sparkassen- und Giroverband
Postfach 11 01 80 · 10831 Berlin

Patrick Büscher
Recht und Steuern
Telefon +49 30 20225-5346
Telefax +49 30 20225-5345
patrick.buescher@dsgv.de

ESMA
CS 60747
103 Rue de Grenelle
75345 Paris Cedex 07
FRANCE

3. August 2012

Comments of the German Savings Banks Association (DSGV) on the Consultation paper ESMA/2012/379 Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories
Ref.: ESMA/2012/379
DSGV-Ref.: 7103

Dear Sir or Madam,

Please find hereafter the Comments of the *Deutscher Sparkassen und Giroverband (DSGV)*[1] on the Consultation paper ESMA/2012/379 Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories.

Yours faithfully,
For
Deutscher Sparkassen- und Giroverband

p.p. Dr. Hartmut Frings

p.p. Patrick Büscher

enclosure

[1] *The Deutscher Sparkassen- und Giroverband (DSGV – German Savings Banks Association) is the umbrella organisation of the Sparkassen-Finanzgruppe (Savings Banks Finance Group), which includes 423 savings banks, eight Landesbank groups, DekaBank, ten Landesbausparkassen, eleven original insurer groups of the savings banks and many other financial service providers.*

A. Introductory Comments

The explanations set out in the consultation paper are commented upon in connection with the relevant provisions in the draft proposals.

Any reference to the Regulation is to be understood as a reference to the Regulation on OTC derivatives, central counterparties and trade repositories. References to any individual provision of the Regulation refer to the Regulation (EU) No 648/2012 of the European Parliament and the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (Official Journal of the EU, 27 July 2012, page 1 ff.). Any reference to a draft delegated regulation is to be understood as a reference to the relevant draft delegated act setting out the regulatory standards or implementing technical standards proposed in the Consultation Paper.

B. General Comments

- We are aware of the fact that every proposed regulation has its own set of definitions, yet a number of these defined terms are used in more than one draft delegated Regulation. This may cause uncertainties over the meaning of such terms as it is unclear whether these have to be interpreted autonomously or whether the definition in a separate delegated regulation is also meant to apply to other Regulations. E.g. we wonder why "confirmation" is defined in Annex V while not defined in Annex II. The same applies to the six classes of derivatives (equity, credit…). We deem it very advantageous to consolidate these definitions into one set making them applicable to all technical standards.
- In view of the international nature of the derivative markets, close coordination between the regulatory authorities in respect of the future international regulatory framework, in particular the recognition of CCPs and trade repositories as well as the classification of counterparties as being subject to a clearing obligation, is of utmost importance. We understand that ESMA and its international counterparts are currently engaged in discussions with a view to ensuring coherence between the regulatory frameworks, including the issue of the recognition of equivalent regulatory provisions. In particular the question of the recognition of a regulatory framework or parts thereof as equivalent will have far reaching practical implications. Market participants are therefore highly interested in obtaining information on the progress of these discussions. With regard to substituted compliance as suggested and possible under the Commodity Futures Trading Commission's (CFTC) Guidance on Cross Border Application of the Swap Provisions of the Dodd-Frank Act it would be of utmost importance that ESMA and national supervisors of EU Member States will enter into a dialogue to determine comparability of EMIR (and possibly other relevant national laws and Regulations) with the Dodd-Frank Act requirements. The CFTC expects that it would enter into memoranda of understanding or similar agreements with relevant foreign supervisors on the the equivalence and comprehensiveness of foreign Regulations. The issue is of such importance that it may merit a separate hearing or at least further communication by ESMA and national supervisors. We deem it very important to determine without any undue delay whether ESMA or national supervisors assume responsibility for substituted compliance with the Dodd-Frank Act.

C. Comments on and queries in respect of individual sections/provisions

I. Annex II – Commission delegated Regulation regarding regulatory technical standards on OTC derivatives

1. Indirect Clearing Arrangements (Art. 1 to 4 ICA of the draft delegated Regulation)

1.1 Art. 2 ICA para. (1):

To avoid uncertainties and in order to ensure an adequate regulatory framework for any client offering indirect clearing services it should be considered specifying those entities that shall be included under the Regulation's scope for the purposes of indirect clearing services. Presumably this should include credit institutions within the meaning of Directive 2006/49/EC but not necessarily all counterparties qualifying as financial counterparties under the Regulation.

1.2 Art. 2 ICA para. (2):

Sentence 1 appears to imply that the client shall have the sole discretion in determining the contractual terms of an indirect clearing arrangement. Moreover, under sentence 2 the contractual terms of an indirect clearing arrangement shall include an obligation on the respective clearing member to "honour any obligations" between the client and its indirect client in the event of a default of the client. This is at least misleading, as a contractual arrangement between the client and the indirect client cannot be binding upon the clearing member. Furthermore, contractual terms concerning the consequences of a default of one of the parties to that contract may not be enforceable or effective under applicable insolvency law in the event of such default. The contractual agreement between the indirect client and the client can therefore only contain provisions setting out an obligation of the client to ensure that the client enters or has entered into a contractual agreement with the relevant clearing member which adequately addresses the consequences of a default of the client for the indirect client and the relevant transaction (or measures to this effect).

Whether and, if so, to what extent these contractual provisions and obligations as agreed between the indirect client and the client on the one hand and the client and the clearing member on the other hand remain applicable or enforceable is a matter of the applicable insolvency law. The risk that these national insolvency laws override the contractually agreed rights of the indirect client can only be averted by further harmonisation of insolvency laws of the Member States and the introduction of special provisions protecting the position of the indirect client in this specific situation. This needs to be recognised when defining or interpreting any requirements which seek to provide protection for purely contractual positions.

The same issue arises in connection with the requirements aimed at protecting the client positions in the event of the default of a clearing member and it is at least recognised in Recital 64 of the Regulation and repeated in Recital 4 of the draft delegated Regulation. However the language in the recitals is not sufficient so as to override existing insolvency laws.

1.3 <u>Art. 3 ICA para. (1):</u>

The meaning, intent and purpose of sentence 1 ("*shall not be subject to business practices by the CCP which act…*") is not clear, the sentence should therefore be deleted.

The comments regarding Art 2 ICA para (2) apply correspondingly to sentence 2: The indirect clearing arrangement cannot subject the CCP to any legal obligations as it is not a party to this agreement.

1.4 <u>Art. 3 ICA para. (2) sentence 2:</u>

Sentence 2 concerns the obligations of and requirements to be met by CCPs and thus should be addressed in the draft regulatory technical standards on CCP requirements.

1.5 <u>Art. 4 ICA para (1)</u>

Para (1) appears to imply that any clearing member will be offering client clearing services and is also able to do so. This, however, may not be the case as some clearing members may have valid reasons not to offer any client clearing services at all (and clear only own transactions). The choice whether and if so, to what extent and under what terms a clearing member is willing to provide clearing services, in particular involving indirect clearing services, cannot be restricted in any way. Para. 1 should therefore be revised and limited to an obligation to make public whether a clearing member is willing to provide these services.

In addition, in order to ensure a consistent framework and level playing field it should be clarified that the provisions in the Regulation (e.g. under Art. 39 of the Regulation) setting out requirements and obligations to be met by clearing members in respect of their clients apply *mutatis mutandis* to clients offering indirect clearing services.

1.6 <u>Art. 4 ICA para (3)</u>

Art. 4 ICA para. (3) refers to Art. 39 (9) of the Regulation which defines the requirements that need to be met with regard to the obligation to distinguish in accounts with the clearing member between assets held for indirect clients. One of these requirements which are thus being incorporated by reference is the obligation to ensure that the positions recorded in an account "are not exposed to losses". In practice, this will primarily concern collateral posted by the indirect client (specifically, the initial margin) and passed on to the CCP.

As long as there are no harmonised special provisions at EU level requiring national laws to protect client positions in view of the specific circumstances of client clearing against the consequences of an insolvency of the account holder, national insolvency laws will always override any contractual arrangement. It will therefore not be possible to ensure complete protection by contractual means alone.

Contractual means achieve a certain level of protection by agreeing on the posting of collateral by way of a pledge (or other similar rights by which an asset becomes the security interest of a third party without affecting the legal title of the original owner). The use of pledging as a means to ensure greater protection in this specific context is, however, restricted in two ways:

First, posting of collateral by way of a pledge only makes sense in connection with pledged securities and not in connection with cash: Cash can never be distinguished in a legally effective manner from other assets of the party receiving the cash. This is because the cash itself is necessarily always intermingled with the assets of the recipient. The party transferring the cash only retains a right to demand repayment from the recipient and only this right can be subject to a pledge. The use of custodian accounts would not materially improve the level of protection: Even if cash is deposited with a third party instead of the secured party, this would not extinguish the credit risk exposure, rather, the risk exposure to the secured party would only be exchanged with that of the third party.

Second, collateral in the form of pledged securities (instead of a full title transfer of securities or cash) can only serve as initial margin. Any collateral to be posted as variation margin needs to be posted by way of full title transfer of securities or cash. This is because the collateral serving as variation margin is subject to constant adjustments in view of the constant changes of the market value. Such constant adjustments of the variation margin cannot be effected in the requisite timeframe and accuracy if the collateral is posted in the form of pledged securities.

Thus, Art. 39 (9) of the Regulation and any similar requirements that call for a certain level of protection by way of contractual means need to be interpreted and applied in such a way that the aforementioned *de facto* constraints for any attempt to ensure full legal protection of the positions by contractual means is taken into account. Otherwise, the regulatory requirements defined by the Regulation and the delegated Regulations could be incompatible with the legal reality.

1.7 Art. 4 ICA para. (6)

The requirement for the clearing member to hold directly positions and assets would give rise to contingent liabilities. These liabilities could in effect increase capital requirements according to the CRR. This would not only make indirect clearing arrangements more expensive but it could also prove counterproductive if clearing members decide not to offer any clearing services anymore.

2. Criteria for the Determination of Classes of OTC Derivative Contracts Subject to the Clearing Obligation (Art. 1 CRI of the draft delegated Regulation)

2.1 Art. 1 CRI – FX

In order to ensure maximum alignment of international rules while preserving full discretion for European standard setters we propose a more detailed elaboration of Recital 19 of the Regulation.

2.2 Art. 1 CRI – covered bonds

Under Recital 16 of the Regulation, ESMA is asked to take into account the specific nature of OTC derivative contracts which are concluded with covered bond issuers or with cover pools for covered bonds in connection with the determination of the classes of derivative contracts to be subjected to the clearing obligation. Consequently, the Regulation appears to grant ESMA the mandate to define criteria under which OTC derivative contracts concluded with covered bond issuers or with cover pools for covered bonds may be classified as not eligible for CCP clearing.

This specific issue is, however, not addressed in the present draft delegated Regulation. Does this mean that ESMA intends to address this particular question in another context, i.e. when determining the individual classes of derivative contracts subject to the clearing obligation?

2.3 Art. 1 CRI para. (3) lit. (b)

We welcome the fact that the potential development of market size and depth over time shall be taken into account. There are a number of derivatives that start with high liquidity, but this liquidity will deteriorate tremendously over the lifetime of the contract (e.g. off the run index CDS). This fact is reflected in the Commission's proposal for MiFIR which concedes that derivatives are no longer deemed eligible for the platform requirement once liquidity drains away.

3. Public register (Art. 1 PR of the draft delegated Regulation)

Art. 1 PR para. (4)

The practical implementation of the clearing obligation will be very challenging. Market participants thus need sufficient time to adjust their processes. The clearing obligation therefore needs to be phased in over a sufficient period of time. The draft proposal allows for such a phase-in, however, it appears to limit the possibility to structure such phase-in solely by categories of counterparties. This will almost certainly be too restrictive. The manner in which a phase-in is to occur should be defined on a case by case basis, allowing a significant degree of flexibility, including the flexibility to structure the phase-in on the basis of categories other than counterparties (i.e. sub-categories of products).

4. Liquidity Fragmentation (Art 1 LF of the draft delegated Regulation)

Art. 1 LF para. (2)

We deem the definition in Art. 1 LF para. (2) to be a rather theoretical and a very binary definition of liquidity fragmentation. ESMA should consider allowing for more differentiation than “fragmented” or “not fragmented”. A strict binary conclusion would make the establishment of effective competition highly unlikely.

5. Non-Financial Counterparties (Art. 1 and 2 NFC of the draft delegated Regulation)

Market participants are not in any position to determine by themselves whether a non-financial counterparty is subject to the clearing obligation or not. For the sake of legal certainty and also in order to prevent a distortion of competition, they need to be able to rely on the information provided by the counterparty. It should be clearly stated in the delegated Regulation that there is no obligation to verify or investigate the information provided by the non-financial party regarding its clearing obligation.

Additionally, it may be possible to require the registration of the identity of all non-financial entities subject to the clearing obligation in a public register. One possible solution could be that the LEI reference data encompasses the information if the legal entity is required to clear. Another option may be a requirement to register all non-financial counterparties becoming subject to the clearing obligation in the public register maintained by ESMA.

6. Risk Mitigation techniques for bilateral transactions (Art. 1 to 8 RM)

6.1 Art. 1 RM para. (2) – timely confirmation

We concur with the time limits proposed and the general concept regarding the confirmation of transactions. However, this is based on the understanding that "confirmation" in this context is interpreted in line with current practice as the (first) confirmation of the key terms by one of the counterparties and not any response to such confirmation from the other counterparty. We also assume that it is not expected that such confirmation covers all aspects of the transaction in minute detail but that it focusses on the key terms.

The current draft delegated Regulation lacks a definition of the term "confirmation". The term "confirmation" is, however, defined in Art. 2(4) of the draft delegated Regulation in Annex V. It is, however, not clear, whether the definition in that delegated Regulation is to apply directly or indirectly to Art. 1 RM. Moreover, the definition in Art. 2(4) of the draft delegated Regulation in Annex V is not compatible with the function and understanding of "confirmation" as currently applied in practice (in particular in the context covered by Art. 1 RM), see also comment on Annex V below. To avoid any uncertainty over the understanding of the term "confirmation", we suggest that it is defined in line with the understanding described above which should also be consistent across all delegated Regulations (in order to avoid uncertainties, ideally in one single section on definitions applicable to all delegated Regulations, see general comments under item B above).

The words *"which is not cleared by a CCP"* are misleading and should be replaced by *"which are not to be cleared"*: The clearing of a transaction (that is its entering into the clearing system of a CCP) follows after the conclusion of the contract.

At least it will be necessary to define what is to be understood under "where available". Availability should only be assumed where an electronic system can be reasonably expected to be employed. This entails to take into account the trade volume on the one hand and the cost of implementing and maintaining such a system on the other.

6.2 Art. 1 RM para. (3) – timely confirmation

The time required for an electronic confirmation can differ considerably depending on the type of the transaction and the market participants involved. In particular, less sophisticated market participants (which would include a significant portion of market participants subsumed under the definition of financial counterparty, in particular small and medium sized banks) will have a significantly less developed infrastructure (human resources, system capacity etc.) for the processing of transactions and thus will generally require more time for transaction processing.

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).

The time limit proposed under Article 1 RM para. 2 appears to be based on benchmarks set by highly sophisticated market participants and in relation to simple transactions. Thus, they cannot be applied to all market participants and in relation to all types of transactions (in particular bespoke transactions). Against this background, a limit of 5 days would be more realistic and would ensure higher quality and greater efficiency of the confirmation process with regard to non-electronic confirmation of less sophisticated market participants. We suggest therefore the following amendment of Article 1 RM para 2:

" *... of the same business day. In case of non-electronic confirmation the OTC derivative contract should be confirmed at the latest by the end of the fourth business day following the business day of the transaction.*"

Besides, to avoid uncertainties we suggest introducing a definition for the terms "business day" and "local time". In both cases this should be the day and time at the place where the confirming party is domiciled.

6.3 Art. 2 RM para. (4) lit. (a) and (b) – thresholds for portfolio reconciliation

The requirements regarding portfolio reconciliation should not be applicable (or deemed to be fulfilled) where the consistency of the respective information is already ensured by other means, such as the use of matching services.

The suggested thresholds for mandatory portfolio reconciliations under Article 2 RM para. 4 are too low with regard to smaller financial counterparties with a limited range of derivative exposure. To recognize the fact that smaller institutions have often just a single-digit number of OTC derivative contracts with low amounts the following "*de-minimis*"-threshold should be added to Article 2 RM para 4 lit. b.:

"*iii. Once per year for a portfolio between 1 and X (e. g. 50) OTC derivative contracts outstanding with a counterparty.*"

6.4 Art. 3 RM – threshold for portfolio compression

Under the current proposal the counterparties would be required to prepare "a reasonable and valid explanation" to be presented to the competent authority (if so requested) in the event the counterparties deem a compression exercise inappropriate.

Portfolio compression can only cover some of the relevant counterparties' own positions, never the entire portfolio. For example, positions required for specific hedging purposes need to be maintained. Therefore, the total number of transactions which may be eligible for compression may be significantly lower than the total number of transactions outstanding between two counterparties. The conclusion that a compression exercise is not appropriate may therefore be not an exceptional but rather a common occurrence.

We kindly request a clarification, e.g. in the recitals, whether the threshold of 500 or more OTC derivative contracts in Article 3 RM para. 2 shall be applicable to financial and non-fincial counterparties.

6.5 Entry into force/phase-in

The requirements under Art. 11 of the Regulation regarding risk mitigation techniques for transactions not cleared by a CCP (bilateral transactions) will cause significant and far reaching changes to operational processes. Market participants will not be able to implement the new requirements immediately. Recital 93 of the Regulation already clarifies that obligations arising under the Regulation which are further developed by implementing acts, in particular technical standards, will only apply as of the date on which the relevant regulations or acts on level 2 defining these obligations start to apply.

While this at least clarifies that the obligations regarding risk mitigation techniques for bilateral transactions do not become applicable before the technical standards defining the actual content of the obligations come into force, this will still not resolve the problem that the implementation of the new requirements can only be initiated on the basis of the final technical standards. Thus, the addressees of these requirements need a certain period of time following the finalisation of the technical standards to adjust their processes to these new requirements.

Although the Regulation does not explicitly provide for the introduction of an implementation/transition period as part of the relevant technical standards, we strongly believe that such transition period is necessary. We therefore expressly welcome that ESMA has been consulting with the European Commission whether it will be possible to introduce such transition period.

6.6 Art. 4 RM para. (2) – dispute resolution

In respect of the proposed obligation to agree on "detailed procedures and processes" it should be taken into account that counterparties must retain the requisite level of flexibility to agree on standards and terms corresponding to their specific needs and legal background. In particular, non-financial counterparties need simple and robust procedures and would have difficulty in subjecting themselves to a highly complex dispute resolution mechanism or dispute resolution mechanisms resulting in the application of the laws of another jurisdiction. Consequently, none of the forthcoming requirements can follow one specific model solution.

6.7 Art. 7 RM – definition intragroup transactions

Along the lines of Art. 7 RM para. 1 we share ESMA's reading that intragroup transactions within a Member State and without any impediments for the transfer of funds are not to be notified to the competent authority because they are exempted from the clearing obligation in general in the level 1-text. Art. 4 para. 2 subpara. 1 of the Regulation stipulates a general exemption whereas subpara. 2 lit. b refers to the cases of cross-border transactions within and outside of the EU.

Irrespective of the remarks above, it should be expressly set out in Art. 7 RM that the relevant notifications do not have to be made individually, in respect of each transaction but rather in the form of a general notification covering all transactions of the relevant group members.

6.8 Covered bonds - unilateral collateral posting

As stated in Recital 24 of the final text of the Regulation, "when developing technical standards to specify the arrangements required for the accurate and appropriate exchange of collateral to manage risks associated with uncleared trades, ESMA should take due account of impediments faced by covered bond issuers or cover pools in providing collateral in a number of Union jurisdictions" and "ESMA should also take into account the fact that preferential claims given to covered bond issuers counterparties on the covered bond issuer's assets provides equivalent protection against counterparty credit risk".

Derivatives used in covered bonds are usually bilaterally collateralized, but in a special way: the counterparty is posting collateral to the covered bond issuer in the usual ways, whereas the covered bond issuer does not have to, because the counterparty's claims are equivalently collateralized by his preferential claims on the cover pool assets securing the covered bonds. In the event of the covered bond issuer's default, the source of payment switches to the cover pool, on which the derivative counterparty has a preferential claim alongside with the covered bond investors. An obligation to exchange collateral bilaterally would constitute a second level of privilege and represent an illegitimate benefit for the counterparty which ranks *pari passu* with the covered bondholders and already benefits from a legal privilege. In some jurisdictions, it is even legally impossible for covered bond cover pools to post initial or variation margins vis-à-vis its derivative counterparties as collateralization is already provided by claims against the cover pool.

Therefore, we believe that the privileged access to the cover pool granted to covered bond counterparties offers an equal risk protection as initial and variation margins, so only the counterparties should be obliged to post collateral.

II. Annex III – Commission delegated Regulation regarding regulatory technical standards on requirements for central counterparties

1. Art. 1 ORG para. (3) lit. (c)

Whilst we agree that a third country seeking recognition should fulfil all the criteria mentioned under para. 1, we are doubtful that requiring the CCP to supply all this information to ESMA would be appropriate. Since Art. 25 para. 2 of the Regulation is a minimum condition for recognition, some of the information required under Art. 1 3C will be submitted twice. While this would not hinder the recognition process per se it might prove counterproductive in establishing a seamless recognition process vis-à-vis other jurisdictions. For example recognition may need more time than necessary and might leave market participants uncertain. Without mutual recognition, transactions between EU institutions and institutions from other jurisdictions in derivatives with a clearing obligation might become impossible. Hence, it is paramount that the recognition process runs without undue delay.

2. Art. 1 RK ff.

A provision should be adopted in Art. 1 RKff. whereby a client has access to the relevant data of the CPP after a novation has taken place.

3. Art. 1 MAR

We do not agree that OTC derivatives demand per se a higher confidence interval than other financial instruments. Derivatives can be more liquid than other instruments and therefore are easier to liquidate. Whether it is necessary to better capture "tail risks" depends on the underlying and not on whether the contract is traded on a regulated market, MTF or OTF (or correspondent concepts in other jurisdictions). The IOSCO-Basel Consultation Paper on "Margin requirements for non-centrally-cleared derivatives" of July 2012 specifies a 99% confidence level for OTC derivatives.

4. Art. 1 COL

With regard to financial instruments, the condition under subsection (b) (i) should additionally include an upper threshold above which the assets would always be considered as having a low credit risk. This threshold could e.g. be based on the credit rating of the financial instrument so any instrument with a rating of minimum AA- or above would fulfill the condition of entailing low credit risk.

We urge ESMA not to overly limit the scope of eligible collateral. EMIR as well as the CRD IV 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 (among other developments raising the need for collateral, e.g. the WGMR's deliberations, see the

Basel document referenced above). 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.

III. Annex V

1. <u>General remarks (especially on Art. 3, Art. 6 and Table 1 / 2 – Details to be reported)</u>

Art. 3 and 6 together with Tables 1 and 2 set out an obligation to report the market value (changes in comparison to the last evaluation) and the amount of collateral posted in view of every single transaction to be reported. The reporting obligation is thereby turned into an obligation to constantly evaluate and report the market valuation of each transaction including its collateralisation.

There is, however, no legal basis for such an extensive and constant reporting obligation in the Regulation and neither does the Regulation provide for a mandate to regulate such far reaching and onerous obligations by way of technical standards. Art. 9 para 1 EMIR requires reporting of "the details of any derivative contract concluded and any modification or termination". The market value (and the collateral posted in this connection) and/or changes thereto are not details of the contract, but rather circumstances lying outside of the contract details themselves. Consequently, the relevant provisions in the draft delegated Regulations exceed the mandate granted under the Regulation. ESMA seems to be aware of this lack of mandate as it adds a fourth amendment "other" in field 63 (only Annex V, in Annex VI "other" is missing). The requirement to report "other" events is not covered by the mandate of Art. 9 para. 6 EMIR, since the technical standards should define details in terms of format and frequency and not add requirements on content.

In addition, the requirements to report market and collateral values are also conflicting and inconsistent with the Regulation itself and other European regulatory requirements. They indirectly subject counterparties to obligations from which they are exempt under the Regulation and they collide with legal concepts accepted and encouraged under other legislative instruments:

First, under Art. 11 (2) of the Regulation the obligation to assess the market value of a transaction is expressly limited to financial counterparties and qualified non-financial counterparties (those exceeding the threshold) for derivative contracts not cleared by a CCP. The reporting obligation as foreseen under Art. 3 (2) and Table 2 of the draft regulatory standards under Annex V would, however, require all counterparties to report market values. This would effectively require them to obtain market valuations.

Second, the requirement to generally demand the reporting of the level of collateralisation on a transaction basis ignores the fact that collateralisation generally occurs on a net basis as a consequence of the risk reducing effect of netting agreements. This practice is accepted and actively encouraged by other regulatory rules, including the present and future legal framework for the capital requirements (Capital Requirements Regulation/Capital Requirements Directive) and the Financial Collateral Directive. Art. 6 of the draft delegated Regulation appears to address this fact to some extent. However, in view of the fact that collateralisation on a net basis (portfolio basis) is the rule and not the exception, Art. 6 and the relevant sections in table 2 need to be revised.

Third, market valuations of positions/collateral to be reported by counterparties will never perfectly match. The information received will thus be conflicting (if both parties report) or inconclusive (if one party reports following a delegation of this obligations).

Therefore, fields 34 and 35 of Table 2, Annex V and Annex VI should be deleted.

2. Art. 1

The term "derivative" is defined in Article 2(5) EMIR by reference to Directive 2004/39/EC. It should be clarified that spot contracts and commercial foreign exchange forwards are not covered by such term and therefore not subject to reporting.

3. Art. 2 – definitions

3.1 Art. 2 para. (1) – "counterparties"

EMIR distinguishes between obligations which have to be met by "financial counterparties" and "non-financial counterparties" on the one hand and obligations to be met by "counterparties" (and thus perhaps even those not falling within the scope of the definition of financial or non-financial counterparty) on the other hand. EMIR itself provides no definition for "counterparties", but ESMA now defines the term "counterparty" as "financial and non-financial counterparties", at least for the purposes of the reporting obligation. In consequence the scope of the addressees of the reporting obligation will not include

- any party to the contract established or living outside the EU (third country entities) and
- any counterparty in the EU not qualifying as an undertaking under European law, in particular case law concerning Art. 101 of the TFEU, which defines undertaking as any entity engaged in an economic activity, regardless of the legal status of the entity or the way in which it is financed.

It would be helpful to know whether the definition of "counterparty" set out in Annex V is intended to apply only in the context of the reporting obligation or is intended to serve as a general definition (which may have considerable practical implications). To give one concrete example, with this understanding of "counterparty" Art. 4 para. 1 (EMIR) would be ill-conceived. Only counterparties shall clear (first three words), but "entities" (Art. 4 para. 1 letter a (iv) and (v) EMIR) are no counterparties following ESMA's definition.

3.2 Art. 2 para. (4) – “confirmation”

The definition of “confirmation” is inconsistent with the understanding and function of a confirmation as applied in practice. The confirmation is not the act of agreement on the terms of a contract (the legal conclusion of the agreement). Rather, it means a separate act whereby one of the parties forwards a notice which intends to confirm what has already been legally agreed. The confirmation thus follows the legal conclusion of an agreement and only serves to provide a record of what has been agreed and to enable the parties to detect potential inconsistencies. The conclusion of the contract occurs as soon as the counterparties agree on the terms of the contract (often via telephone). The confirmation, as a unilateral legal act, thus only covers key aspects/elements and does not settle or cover the agreement in minute detail.

We also refer to our above comments on Annex II, Art. 1 RM and our general suggestion to set out definitions of key terms used in the various delegated Regulations in a separate instrument, or at best in EMIR itself (so as to come also to a consistent understanding with regard to Art. 11 para. 1 EMIR), in order to ensure that the definitions are aligned.

Moreover, the words “any relevant master agreement” should be deleted from the definition of “confirmation”. In practice the master agreement, covering a large number of derivative transactions, is not entered into at the time each derivative contract is confirmed, in some cases the conclusion of the master agreement may date back several years. The date of the conclusion of the master agreement is thus of no practical relevance.

3.3 Art. 2 para. (6) to (11) – definition of derivative classes

There are many instruments that do not clearly belong to only one of the categories. Counterparties thus must be able to allocate these instruments in accordance with their assessment of what class is the most appropriate. It would be favourable if classification of derivative contracts could be made alongside the already existing ISDA product categories. This would clearly minimize inconsistencies regarding the classification of complex derivative contracts.

To mitigate these concerns, it should be clarified whether and under which conditions convertibles are covered by the definition of “equity derivatives”.

Options, forwards and futures on bonds, notes or other debt instruments should be covered by the term “interest rate derivatives”.

Underlyings such as emission certificates, freight, inflation or capacity rights should be assigned to the commodity bucket. Article 8 (page 141) implies that an allocation to an assets class should occur in accordance with the “most closely resembles” principle. The fact that the assets mentioned above are very often traded by the institution's commodity desks would justify their consolidation.

The term "hybrid derivative" should be introduced as a new definition. It should be defined as a contract where the underlying consists of two or more asset classes (e.g., a basket of equity, interest and currency). Hybrids should be allocated to the asset class that constitutes the majority of assets within such basket and is agreed by the counterparties as set forth in Annex V Art. 8 and Annex VI Art. 4 c. The same principle should be applied to units of mutual funds where a look-through approach can be applied.

4. Art. 3 para. (1)

We propose a cross-reference to the implementing technical standard defining the format of the reporting including Tables 1 and 2 of Annex VI.

5. Art. 3 para. (4)

It should be clarified that the reporting party, when reporting on behalf of both counterparties, (i) may not complete fields 15 and 16 of Table 1 and field 22 of Table 2 or, if those fields are completed, (ii) does not accept any responsibility for the correctness of such data.

6. Art. 3 para. (6)

We refer to our comments above concerning the fact that the Regulation does not provide any legal basis for a requirement concerning the reporting of market values.

7. Art. 5

Since "novation" can have different meanings, we urge ESMA to define the meaning. The term should be defined as the mechanism by which the central counterparty imposes itself between the counterparties to the contract (as defined in Article 2(1) EMIR). Any other change in counterparty, which may occur prior to the clearing of the contract (and which may be achieved by a give-up agreement or novation and assumption agreement) should be dealt with as a modification of the contract. It would help the users if ESMA were to illustrate Article 5 and its potential hurdles by means of examples or case studies.

According to the current version, a novation of a contract is treated as a modification pursuant to Art. 5 para. 1. This also has effects on the content of the fields reported according to Tables 1 and 2. We understand that under the currently suggested fields such modification would need to be reported in field 63 of Table 2 of Annex V. However, it is unclear whether the counterparty data of Table 1 would remain the original counterparty – in which case the information reported would not correctly reflect the facts of the transaction. In cases of multiple changes in counterparty prior to clearing of the contract as described above, the contents of the reported fields would in no case of

any of the reported modifications reflect the facts of the contract, e.g. with respect to collateral as the collateral may change with every counterparty.
Introducing a field saying "old counterparty" might be advisable should the rationale behind reporting a novation as a modification (instead of considering it as an entirely new report) consist in an attempt to list the entire chain of counterparties to one derivative contract in one report.

8. Art. 6 para. (1)

"Pledge" does not refer to any specific type of asset used as collateral but rather a certain legal form by which a security interest is vested in a certain asset. We therefore suggest deleting the word "pledge".

9. Art 6 para. (3)

As to our general concerns regarding the obligation to report collateral in respect of a transaction, we refer to our general remarks above. In addition, we would like to point out the following:

Table 1 of Annex V as well as table 1 of Annex VI are missing a data field for reporting the specific contracts over which collateral has been exchanged. This field would need to accommodate up to many hundreds of contract IDs. More likely than not, there is no technical way to store all the data for all contracts concluded between the counterparties (e.g. trade IDs). Therefore Article 6 para. 3 should be deleted.

Moreover, reports on collateral may be made on micro or macro level which provides for a heterogeneous process and additional time, costs and effort. If reporting of collateral should nevertheless be required, we strongly urge ESMA to consider it sufficient to include one field determining whether collateral has been posted for a contract, e.g. flagging the report of a derivate contract with a "yes/no" field.

Specific remarks on Table 2

General

Table 2 is missing all fields for reporting of credit derivatives.

Field 5

If the two counterparties are required to agree on a unique trade ID this should be dealt with by the front office at the time of conclusion of the derivative contract. The unified trade identification should either be generated internally by the counterparties or, if deemed necessary, centrally through a responsible organization. This may reduce the risk of inconsistencies between counterparties in determining the trade ID. This would effectively mitigate all potential problems along the chain of processing the derivative. It should be ensured that field 5 provides for a sufficient number of digits to accommodate the complex trade ID. In addition, as the trade ID refers to the derivative contract between the specific parties, it should be reported in Table 1 rather than Table 2. Otherwise problems of matching reports may occur (i.e. if both counterparties report separately to different trade registers, the reports may not be matched).

Field 18

The master agreement type is not relevant for the terms and conditions agreed for a contract and should be deleted. It is, for example, market practice to enter into credit derivatives under a German Master Agreement for Financial Transactions but to use the 2003 ISDA Credit Derivatives Definitions as a reference. Provided contracts are governed by a new master agreement once they have been approved by the CCP, it should be clarified which master agreement (e.g. the old ISDA Master Agreement or the new F&O Master Agreement with Clearing Addendum) is relevant. Further, collecting master agreements would require considerable efforts and costs because they are stored in separate legal documentation databases.

Field 19

The date to be entered in this field is presumably the date a master agreement was finalized. Since information on the master agreement the transaction is based on is of little practical relevance (see comments immediately above) this also applies to the date the agreement was entered into.

Should the date to be entered not refer to the date on which the master agreement was finalized but rather to the version of the master agreement (that is, the date the relevant master agreement was published), then we would like to point out that the date of the version is of even less practical relevance. In addition, not all master agreements in use are identified by or carry a date indicating the version. Furthermore, such date indicating the version is irrelevant in the case of bespoke or individually adjusted versions of master agreements.

Fields 22-36

All fields should be reviewed under the aspect that they may rather refer to information regarding one of the counterparties and therefore should be reported in Table 1. One example is field 22, which should be reported by the non-financial counterparty, obligated to determine the clearing obligation. The fields referring to collateralization posted by one counterparty should also rather be reported in Table 1.

Fields 27-36

As to our general concerns over any obligation to report information on collateralisation, see our comments above.We doubt that the data fields 27 to 36 would be adequate for reporting collateral. They are rather one dimensional and would not give any meaningful information if, for example, collateral is posted in different currencies. Thus, we propose deleting those fields and replacing them with one single field where a flag should be set determining whether collateral for such derivative contract has been posted or not.

Field 29

It could be clarified that ESMA expects only one value to be entered into field 29 and that if several types of collateral are posted or received, the value “M” (Mixed) should be reported.

Field 30

As a consequence, a value is only to be filled in in field 30 in case of field 29 showing “M” (mixed).

Field 31

As to our general concerns regarding any obligation to report information on collateralisation, see our comments above.

It would need to be clarified what is meant by “collateral” and whether it covers both, initial margin and variation margin. As far as exchange traded derivatives are concerned, the initial margin for each transaction is specified in the clearing house report and the reporting institution would only have to account for any additional initial (bank) margin. The variation margin is exchanged over time and may be received or paid on any business day on which the current market price differs from the closing price on the previous business day. As clearing houses do not apply thresholds or minimum transfer amounts, the aggregated variation margin received and paid since inception of the contract should be the current closing price of the exchange. As far as CCP cleared OTC derivatives are concerned, the same rules apply. For non-cleared OTC derivatives the term “collateral amount” would specify the amount actually posted or received (i.e., after applying thresholds, minimum transfer amounts and rounding rules).

Field 32

It should read “Currency of collateral amount” (see page 173). It should be clarified that ESMA expects only one currency to be reported (even where like under the Standard CSA multiple currencies are used for margining) and that field 33 is only used if the currency is “O” (Other), i.e. not EUR, GBP or USD.

Field 34

We are of the opinion that field 34 should be deleted (see general remarks to Annex V). Alternatively, should this not prove to be an option, we propose that as far as exchange traded derivatives are concerned, the field should show the current closing price of the exchange and not the difference to the amount reported. A “closing price” does not exist for

OTC derivatives. For OTC derivatives market values should be reported and, if cleared, the market values determined by the clearing house which after novation to the CCP are legally relevant for the client relationship.

If mark to market should be reported by both counterparties, delegation of reporting is hardly possible. Mark to market will practically never match perfectly. In consequence, either the reporting party knows the mark to market value of the counterparty which seems to be rather unlikely or the counterparty has to report it to the reporting party thus rendering the delegation useless.

<u>Field 63</u>

It should be specified whether a correction of data is reported as “cancel” and “new” or as “modify”. It should also be specified whether any novation pursuant to Art. 5 should be reported as modification in this field (see also comments to Annex V Art. 5 above).

IV. Annex VI

<u>Article 3 para. (1)</u>

The meaning of lit. (a) (“which is a legal entity if legal entities”) is unclear – the relevant provision needs to be rephrased. Further, there might be a LEI for a counterparty that is an “undertaking” but not a “legal entity”. Does this mean that the LEI is to be ignored and the BIC is to be used? Which identifier is to be used if that undertaking, as may be the case for many non-financials, does not have a BIC code?

<u>Article 4 para. (2)</u>

The questions raised with respect to Article 2 of the draft regulatory technical standard on minimum details of the data to be reported to trade repositories (Annex V) are relevant for the UPI, too (where is the asset class “bond” assigned to?). The derivative types missing are “cap”, “floor” and “collar”. It is also unclear whether a credit default swap is to be reported as a “swap” or as an “option” and whether a total return swap falls under the category “swap”. The term “futures” should be replaced with “futures/forwards” to indicate that both types (exchange traded and OTC) are covered.

As to hybrid products, we refer to our above comments on Art. 8.

<u>Art. 5</u>

Art. 5 para. 1 recognises that the collateral may be reported as exchanged on a portfolio basis. Yet, the relevant reporting fields do not lend themselves to this purpose. The language under Art. 5 para. 2 is incomplete. Provided the requirement calls for disclosure of the contracts affected where collateral is reported on a portfolio basis, fields 27-33 lack the respective option for entering the relevant data.

Art. 6 para. (1) lit. (a)

Provided a transaction register pursuant to Art. 55 EMIR will have been established as per 1 May 2013, Art. 6 para. 1 a) sets out 1 July 2013 as the date on which the reporting requirements will take effect. Consequently, as of 1 July 2013, there will be duplicate reports as far as listed derivatives are concerned. This is due to the fact that listed derivatives are not only subject to the reporting requirement under EMIR. They are also subject to the reporting rules under Art. 25 MiFID I. Whilst it is true that the MiFID amendment will also cover a waiver for reports to trade repositories pursuant to which the latter will be exempt from transaction reporting requirements under MiFID, the timing does not work out: there is no synchronisation between the regulatory procedure under EMIR and the amendment of MiFID. While it is not so much of a problem to submit the same report to different addressees, sending different reports (content, format) to one or different addresses will have negative ramifications for the reporting parties as well as for the receiving parties. For reporting parties it is more costly and a potential source of operational risk, for receivers it will be more difficult to consolidate the data to derive meaningful information. In order to keep the time period of inefficient and expensive duplicate reports short, the coming into effect of the report under EMIR should be postponed (at least) to 1 January 2014. Article 6 Para. 1 a) should be amended accordingly.

Message fields

Table 2

Field 2

We suggest using the ISDA draft taxonomy for the unified product identifier (UPI) .

Fields 22-26

Fields 22-26 on clearing should already be queried in the counterparty data. This is due to the fact that, in qualitative terms, they are closely related to the hedging exemption and the clearing threshold which are equally subsumed under the counterparty data.

Fields 27 to 33

At this juncture, the problem is that in practice, collateral is usually exchanged on a portfolio basis. ESMA's proposed reporting fields fail to reflect this reality. This is due to the fact that the reporting fields do not allow any breakdown into several currencies in cases where there is a collateral package involving several currencies. A solution would have been more appropriate under which, similar to the mandatory information to be provided in field 27, it would merely be necessary to disclose whether collateral was provided or not. Field 33 should be deleted and other currencies should be specified directly in field 32.

Furthermore, the collateralisation of each contractual party will be calculated separately with corresponding minor changes. Hence, the remaining fields 27-32 Table 2 – Common Data should be transferred to Table 1 – Counterparty Data.

Field 29

There is an “S” missing and it should refer to “shares” and not to “securities”.

Field 34, 35

See above (III. 1.)

Field 63

Field 63 seeks to specify changes in a derivatives contract that is subject to mandatory reporting. If the collateralisation is subject to the mandatory reporting requirement too, the categories under field 63 fail to capture this scenario. Collateralisation does not constitute a modification of a derivatives contract. Hence, the options under field 63 should be complemented to include a category called "Other”.