POSITION PAPER

ESBG Response to ESMA's consultation paper on Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories.

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The European Savings Banks Group (ESBG) welcomes the opportunity to make comments on ESMA's consultation paper on Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories. Please find below some comments.

Indirect Clearing arrangements

The inclusion of indirect clearing arrangements envisaging that an entity can satisfy its clearing obligation by becoming a clearing member, a client of a clearing member or a client of a client of a clearing member is welcomed.

A crucial point is to clarify what is meant by "indirect clearing". The term "indirect clearing" broadly refers to a structure where the client does not have a direct relationship with the clearing member and instead the client faces a broker who is not a clearing member (an "intermediary broker"). Such an intermediary broker then passes the client's trade on to the clearing member for clearing.

However, the legal structure of such a relationship could be structured in various ways.

- The intermediary broker could clear the client's trades by **acting as an agent on behalf of the client**. It would enter into a clearing agreement with the clearing member as an agent on behalf of its clients.
- The clearing member can have a **direct principal to principal relationship** with the direct clearing member who in turn enters into a clearing arrangement with an indirect clearing member; the contractual chain could be CCP - Clearing Member - Direct Client - Indirect Client - Client of Indirect Client, etc.
- Any other legal structure combining the agent model and the principal model.

It is important to recognise that the precise way in which these indirect clearing models are structured is crucial to the risk mitigation required by the clearing obligation of OTC derivatives.

It is not clear whether the minimum requirements for indirect clearing arrangements protect the indirect clients' assets and positions from default further up in the transaction chain. This suggests that indirect clearing arrangements should be based on master agreements in order to **achieve standardisation**, conformation to market practice and ensure that indirect clients remain sufficiently protected in the whole transaction chain and ensure portability, independently of the different insolvency laws applicable in the transaction chain.

Moreover, to the extent that such parties rely on members of the clearing service, there is potential for **considerable legal complexity** to result from the nature of arrangements which they make. In that sense, any precise identification regarding, on the one hand, information to be given to the clearing member, and, on the other hand, Chinese walls to be established to protect the information provided by the client to the clearing member. The indirect clearing arrangements cannot be used for commercial purposes, and would further ensure the required safety shelter.

To avoid uncertainties and in order to ensure an adequate regulatory framework for any client offering indirect clearing services, one should specify those entities that shall be included under the Regulation 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.

Risk mitigation for OTC derivative contracts not cleared by a CCP

Regarding the risk mitigation techniques for OTC derivative contracts not cleared by a CCP and their **entry into force**, Recital 93 of EMIR states that any obligation imposed by EMIR and which is to be further developed by means of acts adopted under Articles 290 and 291 TFEU should be understood as applying only from the date on which those acts take effect. However, EMIR Article 11 does not include any provisions providing for RTS to specify an effective date or phase-in of the risk mitigation obligations. It would be impractical if the risk mitigation obligations were to come into force before the relevant technical standards have been adopted. 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 a 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.

Regarding **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 take into account the trade volume on the one hand and the cost of implementing and maintaining such a system on the other.

Procedures for decisively resolving disagreements between parties as to the value of derivatives, particularly when the correct amount of collateral is to be calculated, are very useful. However, the draft Technical Standards specify matters and topics to be included in the procedures and processes of **dispute resolution** but do not determine their details. Above all, there is a risk of duplication and potentially conflicting with existing industry standards and contractual arrangements that already provide mechanism for dealing with disputes. Nevertheless, 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.

Contracts having a "**direct, substantial and foreseeable effect**" within the EU shall be cleared or apply risk mitigation techniques. What is a "direct, substantial and foreseeable effect" of an OTC derivative in a global financial world? The scope of application of this concept has significant implication on the global nature of the OTC derivatives market and should be precisely defined, for ease of implementation and to prevent the evasion of an EMIR application. In the absence of an agreement between the US and EU regulators, extraterritoriality has the potential to cause intractable and irreconcilable conflicts for the derivatives industry. It is currently unclear how EMIR will apply to foreign branches of EU-incorporated entities and EU branches of non-EU entities.

Definition of "confirmation" in the ANNEX V - Draft regulatory technical standards on trade repositories (Article 2 (4))

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 enable the parties to detect potential inconsistencies. The conclusion of the contract occurs at the time the counterparties agree on the terms of the contract (often via telephone). The confirmation, as a one-side legal act, thus only covers key aspects/elements and does not settle or cover the agreement in minute detail.

We suggest to set out definitions of key terms used in the various delegated regulations in a separate instrument, or at best in EMIR itself (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 force at the time that 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.

Annex VI, Art. 6 para. 1 a)

Provided that a transaction register pursuant to Art. 55 EMIR will have been established as from 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, but also 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.

About ESBG (European Savings Banks Group)

ESBG – The European Voice of Savings and Retail Banking

ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising of approximately one-third of the retail banking market in Europe, with total assets of over €7,470 billion, non-bank deposits of €3,400 billion and non-bank loans of €4,000 billion (31 December 2010). It represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

ESBG members are typically savings and retail banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their region. ESBG member banks have reinvested responsibly in their region for many decades and are a distinct benchmark for corporate social responsibility activities throughout Europe and the world.

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