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ESMA/2012/379 Consultation Paper
Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories
OMIClear contribution [03.August.2012]

Dear Sirs,

We welcome the opportunity to comment ESMA proposals concerning the Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories.

Our comments are organised according to the sequence of Articles and only address the first two global topics: OTC derivatives and CCP requirements.

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Article	Comments
General Remarks	
GR.1	EMIR clearly establishes a fair principle of proportionality in the general provisions that should apply to organization of the CCPs. In fact, e.g. in Article 26, it is clearly established that the systems, resources and procedures should be adapted to the CCP situation, namely the complexity, variety and type of services and activities performed. The application of this fundamental principle to the EMIR RTS would dictate the need to take into account the type, level and complexity of activity of the CCPs, for example considering its systemic relevance. This is not followed consistently in all the RTS requirements. In fact, at least three levels of compliance in the application of the proportionality criterion can be found: – With regard to the requirements relating to the nuclear clearing activities, and although we may disagree with some of the proposed solutions, proportional solutions are taken, namely at the level of margins, default fund, skin in the game, etc. – Concerning the capital requirements, the approach is more nuanced, namely the CCP requirements are not so sensible to activity and dimension as what is currently applicable in the banking sector. – Finally, on organizational matters, namely systems, resources and procedures there is no differentiation at all according to activity or systemic relevance, being adopted the same requirements for large (high systemic relevant) and small (minor systemic relevance) CCPs. Concerning the last topic, we admit that this uniformity should apply to some of the variables, but there are others that require a different treatment. As a mere example, please consider the minimum prescribed down time of 2 hours referred

	to in Article 1 BC (6). Such a requirement might be relevant for CCPs which clear, on average, several trades per second, but practically irrelevant to those which need only to clear a few trades per day. This topic, like others, should not be prescribed independently of CCP dimension and relevance but instead be defined by the CCP based on specific objective criteria. Additionally, most of the underlying requirements are formulated taking the increased relevance of the CCPs considering the clearing obligation. Even with this obligation there are sound worries that the competitiveness of European CCPs will be eroded face to its international competitors, due to a too stringent EMIR/RTS regulation framework. The uniform application of this demanding framework to those CCPs which will not be considered systemic relevant will have devastating competitive consequences – they will become ineffectively oversized and financially unsustainable.
GR.2	We want to express our support to all comments contained in EACH contribution to this Consultation Paper.
Part 1, OTC Derivatives – Chapter III, Clearing Obligation Procedure - Notification to ESMA	
Article 1 DET	Some of the data required under Article 1 DET can be highly difficult or impossible to be found, namely: – data on the volume of the class of OTC derivative contracts – data on the liquidity of the class of OTC derivative contracts – the type and number of counterparties active and expected to be active within the market for the class of OTC derivative contracts if it becomes subject to the clearing obligation – information on the risk management, legal and operational capacity of the range of counterparties active in the market for the class of OTC derivative contracts if it becomes subject to the clearing obligation – the number of transactions – the total open interest – the depth of orders including the average number of orders and of requests for quotes – the tightness of spread – the measures of liquidity under stressed market conditions – data on the daily reference price as well as the number of days per year with reference price it considers reliable over the previous 12 months Some of the values will be certainly assumed as simple forecasts without a sound basis.
Part 1, OTC Derivatives – Chapter VII, Non-Financial Counterparties	
Article 1 NFC (2)	EMIR Art. 10(3) establishes a reference to OTC derivative contracts. The RTS draft broadens the scope to all derivatives contracts which does not seem to be possible.
Part 2, CCP Requirements – Chapter IV, Organisational Requirements	
Article 7 ORG (1)	Some of the information that a CCP is required to make available to the public is too extensive and, from our standpoint, not needed and not useful, considering that the public is not a CCP counterpart and has little interest in following the CCP activity. We do agree that some of this information should be available to CCP direct counterparts (clearing members) and indirect counterparts (clients), both named (Ctps), through its clearing member. Moreover, parts of the information that might be included in the scope of the diffusion are highly sensitive for safety or commercial reasons and should not be disclosed in a way that could negatively impact the CCP's business strategy or its operational activity. Information availability which should be reconsidered:

	(a) governance arrangements – only to Ctps, it is not relevant to the public (a) key objectives and strategies – this is critical to others types of stakeholders (shareholders, etc.), and naturally will be a key issue in the relationship with clearing members. This should not be made public, for commercial reasons. (c) relevant business continuity information – only to Ctps. This should not be made public, for safety reasons. (d) key elements of the remuneration policy – only to Ctps. This should not be made public, for commercial reasons. A new entrant (Ctp candidate) can gather the relevant information through members, clients or directly with the CCP.
Article 7 ORG (2)	Similar comments to (1). We do not agree with the mandatory information disclosure to the public of material changes in CCPs governance arrangements, objectives, strategies and key policies.
Article 7 ORG (3)(4)	It is not clear a differentiation between Ctps and the public in what concerns CCP information availability requirements under this Article. No relevant objections concerning Ctps information, meaning that the information to the public should be reanalysed. The only objection on Ctps information is that all information should be made available to Clients through clearing members.
Part 2, CCP Requirements – Chapter V, Record Keeping	
Article 1 RK (2)	Under Article 29 (5) of EMIR, the mandate to ESMA is "to determine the format of the records and information to be retained." We have doubts if the following requirements are covered by the mandate: (b) it is possible to record, trace and retrieve the original content of a record before any corrections or other amendments; (c) it is not possible for the records to be manipulated or altered. Furthermore some of the issues will be difficult to assure as they are stated: "it is not possible", the CCP can put in place organizational procedures to minimize this risk but not to guarantee it at 100%.
Article 3 RK (2)	Even considering the sentence "to the extent they are linked to the position in question", it will be difficult to identify the link between "each position" and the: – amounts of margins, if the position is included in a portfolio – default fund contributions – other financial resources
Article 4 RK (b)	We do not agree with the requirement of maintaining and making available the records on: (f) the minutes of consultation groups with clearing members and clients, if any; (g) reports by (…) consultant companies; (r) the relevant documents describing the development of new business initiatives. These types of documents are internal, correspond to a CCP initiative, can be commercially sensitive and its disclosure shall not be mandatory.
Article 6 RK (2) (3)	Under Article 29 (5) of EMIR, the mandate to ESMA is "to determine the format of the records and information to be retained."

	We have doubts if the numbers (2) and (3) are covered by the mandate, since both are related with timings and accessibility – not format and content. To comply with both topics is not a problem.
Part 2, CCP Requirements – Chapter VI, Business Continuity	
Article 1 BC (6)(7)	We are assuming that the paragraph: "At a minimum, the CCP shall ensure recovery of its critical functions within 2 hours." intends to mean: "the CCP shall ensure recovery of its critical functions in less than 2 hours". If our interpretation is incorrect please disregard the observation below. As mentioned in the General Remark, the RTS should emphasize a proportional approach in the organizational issues. The down time standard is a critical issue because it involves high investments which can easily be oversized if its setting is totally independent on the CCP activity, dimension and overall environment, as it seems to be the case.. Considering the current standards, the 2 hours maximum down time will certainly be a demanding goal even for big CCPs. This requirement empties the fair statement established in number 7: "A CCP shall take into account the potential overall impact on market efficiency in determining the recovery times for each function." This maximum down time standard should theoretically be linked to market impacts/demand (eg. number or value of registered trades per time unit). Combining this with number (7) statement, we propose a criterion based approach assuming the 2 hours not mandatory, but a reference. CCP that opts not to comply with this standard shall justify it properly in order to have its BC procedures approved. If we have understood it properly, this approach seems consistent with the framework proposed for Margins established in Article 1 MAR (3): "The CCP shall inform its competent authority on the criteria considered to determine the percentage applied to the calculation of the margins for each class of financial instruments and shall justify appropriately any departure of the above framework."
Part 2, CCP Requirements – Chapter VII, Margins	
Article 1 MAR Article 3 MAR	Considering the EMIR definition: "'OTC derivative' or 'OTC derivative contract' means a derivative contract the execution of which does not take place on a regulated market" We would like to have clarified if a trade executed OTC (bilaterally for example) on an exchange traded/listed product and then registered with a CCP will be managed according an OTC trade (99.5%, 5 days) or under a non OTC trade (99%, 2 days) if the two different risk approaches proposed go ahead. We have doubts if the criterion of segmentation of products used in Articles 1 and 3 is the most effective. We admit a deficiency of interpretation, but its applicability definition raises doubts according to its scope. 1. If the definition refers to a global approach, i.e. "OTC transactions are those relating to an instrument that is not listed on a regulated market", the following issues arise: Impact of regulated market

	It would be sufficient, in the literal sense, an admission in a regulated market to compromise the OTC nature of operations. Not wanting to be linked to a literal interpretation, we would have to understand the extent to which a regulated market can withdraw the characteristics, which led, inter alia, the ESMA to attribute these trades distinct risk parameters. There is, therefore, a matter of relevance. <u>Impact on operations</u> Admitting that the regulated environment impacts (in a good sense) OTC (eg. bilateral) transactions, it should be clearly established which trades would benefit from this non-OTC classification: – All? Certainly not, because some would maintain its bilateral character, particularly in the balance sheets of counterparties. – Only those who were recorded on a CCP? It would be a possible approach, but it would raise other issues: on all CCPs or only on CCPs which assure regulated markets clearing? 2. If, on the contrary, the approach takes a trade perspective, this has relevant consequences because it would be, for a product to date equal, a distinctive feature that would undermine its fungibility, generating, in practice, another contract. In addition to operational impacts, unneeded, it closes another source of liquidity (the exchange order book). This is a way to avoid. Faced with these alternatives we suggest an amendment to the wording of articles (1) and (3), proposing the following alternatives: a. for derivatives which are not traded in a relevant regulated market, XX%, Y business days. b. for derivatives which are traded in a relevant regulated market, KK% K business days or a. for derivatives which are not traded in a relevant regulated market cleared by the CCP, XX%, Y business days. b. for derivatives which are traded in a relevant regulated market cleared by the CCP, KK% K business days We think that these solutions are intended to achieve the goal of Articles (1) and (3), avoiding some of the problems that the current wording seems to raise.
Article 4 MAR	We proposed to take out the word “negative” where linked to correlation since the signal for derivatives is worthless (the long/short adjusts it). The maximum offset of 80% of the correlation is difficult to understand, particularly when there are instruments (synthetics) built on the combination of others. Simple examples: a call + put = future, quarter power contracts are just the sum of the 3 monthly contracts, the same is applicable to years/quarters/months. This means that a X MW contract in a quarter is fully hedged with X MW contracts in the 3 corresponding months. Cascading is used for a long time in the power business recognizing this overlapping of contracts. Limiting these types of offsets with a discretionary number of 80% will increase costs at two levels: higher margins and, more important, much higher transaction costs by a reduction of liquidity, which will mean higher margins again, etc. On the other side of the equation safety will not be improved – the gains will be marginal above a certain reasonable level and will be eroded by less liquid markets. As a conclusion, we propose a criteria based approach for number (4) simply taking out the cap of 80%: 4. The amount of margin offsets shall be proportional to the level of correlation evidenced.

	~~The maximum offset shall be calculated as 80% of the correlation~~ for the time horizon for calculation of historical volatility as defined in Article 2 MAR.
Part 2, CCP Requirements – Chapter IX, Liquidity Risk Controls	
Article 2 LIQ (1)	In this Article five liquidity sources are mentioned. Besides these mechanisms a CCP should be allowed to use pre-arranged credit agreements with non-defaulting clearing members, if the CCP can demonstrate that: – the liquidity is readily available, on a same-day basis; – these funding arrangements are highly reliable, providing the same degree of security of the other mentioned alternatives, including in stressed market conditions. These funding agreements are supported in EMIR Article 44 (1) which establishes that a CCP "(…) shall obtain the necessary credit lines or similar arrangements to cover its liquidity needs in case the financial resources at its disposal are not immediately available." Analysing the five alternatives mentioned in Article 2 LIQ, the proposed solution is the one that fits better the wording "similar arrangements". From a market standpoint the solution should be sustainable, safe and acceptable. Clearing members are familiar with these types of concepts, particularly due their participation in default funds. The main difference is that in this liquidity risk arrangement the clearing member credit risk should be virtually null, which is not the case in the case of a default fund. As a matter of fact non-defaulting clearing members are already indirectly involved in the liquidity arrangements though the use of its collateral. Please consider Article 2 LIQ (3): "Committed lines of credit that are provided against collateral provided by clearing members shall not be double counted as liquid resources." In conclusion, we can't identify sound reasons to avoid this kind of solutions, particularly when they are already employed in default fund management but with burdensome consequences.
Part 2, CCP Requirements – Chapter X, Default Waterfall	
Article 1 DW	EMIR Article 16 (2) establishes a sound principle: "A CCP's capital, including retained earnings and reserves, shall be proportionate to the risk stemming from the activities of the CCP." It then mandates EBA to propose capital requirements to fulfill this principle. Under Article 1 DW, ESMA establishes the CCP contribution floor to the default waterfall. The proposed solution motivates three types of comments. 1. Concerning the method, we understand the conflicts of interest in indexing the skin in the game to margins or default fund contributions, but indexing it to "operational risk" capital doesn't seem a superior solution, particularly when these requirements are clearly an adaptation to CCPs business. 2. Concerning the indexation, it shall be clear which the calculation basis is. According the principle of proportionality established in above mentioned EMIR article, the basis is the capital required under the RTS which is being proposed by EBA. Accordingly we propose the replacement of the word "held" by "required", or, to be more clear: *"This amount shall be at least equal to the 50 per cent of the capital, including retained earnings and reserves, required to ensure an orderly winding-down or restructuring of the*

activities over an appropriate time span and an adequate protection of the CCP against credit, counterparty, market, operational, legal and business risks, in accordance with Article 16(2) of Regulation (EU) No xx/xxxx [EMIR]."

3. Finally concerning the value, and assuming the method, we consider it is too demanding for a CCP recognizing that it is important for a CCP to have a "skin in a game".

We consider that the key issue in this definition is establishing the CCP obligation to contribute, with high priority, to the Default Waterfall. This puts the topic on the agenda and will, of course, require the market – the CCP and its counterparts – to establish jointly the value that they consider most appropriate. If there is a dominant position in this negotiation, this is certainly not of the CCPs, as services providers and taking into account the degree of competition in the European industry.

The definition of a very high level, as is the case 50%, has the following drawbacks:

- Empties the ability of the parties – CCPs and clearing members – to find a balance point that they consider most appropriate, for example, the equivalent to 10% of the metric used by ESMA.
- CCPs will be tempted, then with fewer restrictions, to favor initial margins to the detriment of the contributions to the default fund, since this is only activated after its own contribution. That is, one of the objectives of the ESMA, to not index the skin in the game to margins or default fund gets eroded.
- The value of the contribution of the CCP will always be reduced vis-à-vis global margins of the market, which means that the skin in the game, when used, can be used in a high percentage, making it extremely costly its successive replacement by the shareholders, in particularly if we consider the high anticipated amounts that are being established in EBA RTS. This will elevate the business risk of CCPs which, in conjunction with a very competitive environment, result in financing difficulties of the activity, scaring away investors. It is not a desirable panorama for a type of entities intended to be central in the financial system.

We propose, therefore:

- A clarification of the indexation
- A reduction in the parameter to a value on the order of 10%.

Part 2, CCP Requirements – Chapter XI, Collateral

Article 1 COL

We welcome the possibility of using commercial bank guarantees as collateral, but the condition (viii) imposing that they must be "fully backed by collateral", will make the rule almost worthless, because it will impose a too demanding requirement.

Concentrating ourselves in the statement, the rest of conditions imposed to the issuer, currency, etc. are enough to guarantee its fulfillment. The risk of not being hounoured by a bank can be split in two levels:

- The risk of a bank default, quite improbable considering risk and the cumulative probability with the default of a non-financial clearing member.
- The risk of bank non fulfillment. This risk, which is low, should be managed not with burden which most probably will inhibits the mechanism but with a legal solution which makes mandatory the fulfillment of bank guarantees established specifically for this goal.

The solution designed has contradictory consequences. The will to establish a direct relationship between clients (and indirect clients!) and the CCPs is clearly highlighted in EMIR and the RTS, namely by segregation allowing them to post their own collateral directly with the CCPs.

The list of assets eligible as highly liquid collateral is composed by:

	– Cash – Commercial banks guarantees – Financial instruments – Guarantee issued by a central bank – Gold From this list, non-financial counterparties, especially industrial companies, will be restricted to use only the first two – typically they don't own available eligible financial instruments and gold. If there are too much requirements to the use of commercial bank guarantees, they will restricted to use cash – currently the most demanded asset. Consequences for the use of derivatives by non-financial counterparties: – Reduce its use, even for hedging – If they out of the clearing obligation, they will not clear them – it will much cheaper (the gap will become wider) to maintain bilateral relationships – the systemic goal of central clearing will be eroded. – I they fall under the clearing obligation, non-financial counterparties will prefer not to bypass financial (clearing) members in order to get additional flexibility concerning collateral – the segregation goal will be compromised. It worth's also to mention that the wrong way risk control is much tighter in commercial bank guarantees *"is not issued by an entity that is part of the same group as the non-financial clearing member covered by the guarantee"* than (probably not used) financial instruments pledged by non-financial entities *"are not otherwise subject to significant wrong-way risk".* In conclusion, we propose: – To withdraw the "fully backed by collateral" burden from commercial bank guarantees – To reinforce, as much as possible, the legal CCP execution capacity of commercial bank guarantees (sub-paragraph (iv)), for example imposing a central bank direct debit clause – a specific right of CCPs (only applicable to declared default purposes).
Article 4 COL	The application of the 10% concentration limits to small CCPs can become almost impossible to comply. This would not mean the risk is higher, since its dimension will certainly compensate a higher concentration ratio. An alternative should be provided to accommodate these cases, for example applying a segmentation according its systemic relevance.
Part 2, CCP Requirements – Chapter XII, Investment Policy	
Article 1 INV (2)	After establishing tight rules concerning investments in number (1), it would be better to clarify the goal a defining a standard based in the "CCP aim". Besides, CCPs, being private companies, will have a justifiable global aim of profitability and the management of its resources, under certain objective limits, makes naturally part of this policy. We propose the deletion of this number.
Part 2, CCP Requirements – Chapter XIII - Review of Models, Stress Testing and Back Testing	
Article 1 SBT	The Risk Committee should be considered as a qualified and independent party concerning risk model validations (1) and price estimates (6) and all other risk management controls. Otherwise the process will become ineffectively oversized.
Article 15 SBT	We think the information referred in this Article shall be disclosed to the CCP counterparts: clearing members and clients. We do not expect to disclose this information to the public in general, in the same way the credit relationships between commercial counterparts are not disclosed to the public or competitors. Moreover all CCP activity is already scrutinized by a

	full set of supervising authorities which have real time access to most its data and can request for additional information or clarification. Proposal: the removal of this Article.