****

 **1st of August 2012**

**ESMA Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories**

**FBF’s RESPONSE**

**General remarks:**

**The French Banking Federation (FBF**) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, *i.e.* more than 500 commercial, cooperative and mutual banks. They employ 400,000 people in France and around the world, and serve 48 million customers.

First of all, the FBF welcomes the opportunity given by ESMA to give its views on the different aspects contained in this consultation in the context of the implementation of the Regulation on OTC derivatives, CCPs, and Trade Repositories (“EMIR”).

This regulation is an important part of the commitments undertaken by the G-20 leaders in September 2009 to impose, by the end of 2012, the use of Central Counterparties (CCPs) for all standardized OTC derivatives contracts and reporting requirements for trade repositories.

 While the FBF welcomes this measure which will enable Europe's markets to reinforce their security as they set in place the commitments by the G-20, it also has a number of comments to make regarding the proposed regulatory and implementing technical standards.

Consequently, and even if we understand the political constraints represented by the G-20 commitments, we strongly believe that in front of such a technical and important legal framework which aims at strengthen financial stability, European regulators, and the whole financial industry should be given the necessary time to adapt to the operational and financial impacts of such regulation with appropriate phased-in implementation periods.

In comparison, one should bear in mind that in the United States, numbers of phase-in implementation periods have been introduced to comply with the rules of the Dodd Frank Act (depending on the types of counterparties and/or financial products) to ensure a secured and balanced implementation of this new financial legal framework.

It is of the utmost importance that ESMA, together with the European Commission clarify the effective implementation date of the EMIR regulation as adoption of regulatory technical standards will be delayed on a number of aspects. In any case it should be avoided that all obligations have not a similar date of effectiveness, otherwise it would create a general uncertainty for all entities that will have to comply with the provisions of the EMIR Regulation.

\* \*

\*

**I. OTC DERIVATIVES (Annex II)**

**CHAPTER I – General**

As a general remark we would like to stress that it is of the utmost importance that sufficiently long phase-in periods are foreseen to implement the EMIR provisions, as they give rise to very significant modifications in many areas:

 - Processes evolution;

 - Bilateral contracts to be renegotiated;

 - Additional resources to be found;

 - Modification of legal set-up.

As mentioned above on this respect, harmonisation of the time frame with the other jurisdictions (US in particular) is very important to avoid regulatory arbitrage and unlevel playing field.

**CHAPTER II – Indirect clearing arrangements**

The FBF understands that for a global framework which affords all entities subject to clearing obligation to fulfill their obligation is fundamental to have an indirect clearing possibility but that features and despite the proposal of definition made by ESMA shall not endanger the smooth market equilibrium.

Therefore the FBF considers that ESMA shall be more compliant with level 1 regulation. Under recital 33, EMIR states that “As not all market participants that are subject to the clearing obligation are able to become clearing members of the CCP, they should have the possibility to access CCPs as clients or indirect clients subject to certain conditions.

We believe in terms of market safety more appropriate to apply the concept of indirect clearing to the CCP level, i.e that indirect clients would be clients of the clearing member instead of clients of clients of a clearing member.

Moreover there is no matter of competition which could have prevented the access of clients to CCP level as many clearing members are in competition to provide these services to clients.

Eventually, the indirect clearing obligation as it is set up presently may go beyond the legitimate need for market and client protection. We invite ESMA to consider the drawbacks. Indirect clearing could be detrimental to direct clearing which is the core of the clearing.

In such a context there are a number of issues that would deserve to be covered by the regulatory technical standards, notably those related to segregation and portability at the CCP level.

Would ESMA maintain its proposal for the definition of indirect clearing, the FBF has the following comments:

***Art 1 to 3***

The FBF welcomes ESMA's efforts to flesh out and define the relatively new and difficult concept, in the OTC derivatives landscape, of indirect clearing. The draft RTS take a significant step in the right direction. However, numbers of provisions in Chapter II, ICA require further thought and clarification because of the legal, commercial and operational uncertainty that they appear to give rise to. And, it is our strongly held view that the implementation of the indirect clearing obligation should be phased-in at an appropriate future date.

In our view, the following issues require urgent clarification:

1. Article 2 ICA (1) appears to state that the contractual terms of an indirect clearing arrangement shall be defined by the client providing the service and not by the clearing member. We do not understand the logic of this approach, particularly bearing in mind the obligations imposed upon clearing members by the draft RTS. In other words, if clearing members are assuming primarily the default risks of a CCP and/or the intermediate client, shouldn't the clearing members be defining the contractual terms of the arrangements?

2. Article 4 ICA (1) appears to impose a mandatory requirement on clearing members to offering indirect clearing. We would ask ESMA to confirm that the intention of this provision and that the use of the term "facilitate" is synonymous with the term "offer". It is possible to read Article 4 as simply stating that clearing members are not under a mandatory obligation to facilitate indirect clearing, but should they choose to do so, they must do so on reasonable commercial terms. The latter reading is consistent with the Level 1 text which does not impose a mandatory obligation on clearing members to facilitate indirect clearing albeit in our view if ESMA had intended this it would have stated so unequivocally. Having said that, it is not clear to us that EMSA has a legitimate mandate in this regard, in other words we cannot find any basis in the Level 1 text upon which ESMA can seek to impose a mandatory obligation in Level 2. ESMA should also clarify what benchmark is being used and on which basis commercial terms might be considered as “reasonable” and whether it belongs or not to this authority to determine whether or not the commercial terms negotiated between the parties are reasonable?

It is important for ESMA to understand that not all clearing members will be in a position to offer indirect clearing; indeed, there may be persuasive commercial or infrastructure reasons why they cannot or may not wish to offer this service. Imposing a mandatory obligation on clearing members to facilitate indirect clearing could have the unintended and perverse consequence that a number of clearing members discontinue acting as clearing members for clients and simply clear their own proprietary positions.

3. Article 4 ICA (6) imposes a mandatory obligation on clearing members to hold end client positions and assets for at least 30 days on reasonable commercial terms where such positions and assets cannot be ported upon a default. We would be grateful if ESMA could clarify if this mandatory 30 day holding period precedes liquidation of the client's portfolio or is contemporaneous with such liquidation. In addition, we would be grateful if ESMA could clarify the basis upon which the 30 day minimum holding period is derived and how this requirement relates to Article 2 ICA (2); we assume that the Article 4 ICA (6) obligation is supplemental to the obligations referred to in Article 2 ICA (2), but in any event we would welcome clarification from EMSA as to how clearing members must "honour" the contractual obligations between clients and their end clients following a client default. We would also request ESMA to clarify the meaning of the legally uncertain term "honour". Given the credit and market risks being assumed by clearing members in such circumstances, one would expect client positions to be liquidated as quickly as possible and CCP rules typically permit positions to be liquidated relatively quickly following a default..

4. Article 4 ICA (4) requires clearing members to establish robust default management procedures to manage client defaults and also requires CCPs to support such procedures. However, it remains unclear how this can be facilitated without a clear legal framework equivalent to, for example, the UK's Part VII Companies Act 1989 framework.

The FBF would also ask ESMA to clarify how clearing members are supposed to manage the transfer or liquidation of positions and assets in the absence of a robust legal framework supporting default management, and whether it is the EMSA's view that such matters be resolved by domestic legislatures and competent authorities.

***Art 4 – Obligations of clearing members and clients***

As already mentioned, ESMA’s proposal is not clear enough on what should be facilitated: “indirect clearing arrangements” or “reasonable commercial terms”?

To avoid any misunderstanding, the FBF suggests that the wording of this article 4ICA(1) is modified as follows:

“*Where a clearing member provides indirect clearing to its clients, it should be required to facilitate the corresponding arrangements on reasonable commercial terms.*”

**Chapter III – Clearing obligation procedure / Notification to ESMA**

***Art 1 – Details to be included in the notification from the competent authority to ESMA***

No comments

**Chapter IV – Criteria for the determination of the classes of OTC derivative contracts subject to the clearing obligation**

***Art 1 – Criteria to be assessed by ESMA***

The FBF supports the two-fold approach retained by ESMA to assess the degree of standardisation of OTC derivative products.

**Chapter V – Public register**

The FBF globally agrees with the proposals made by ESMA.

In addition more specific information should be provided on when exactly the clearing obligation will apply once ESMA has been notified by a competent authority for the authorisation of a CCP and once a CCP has been authorised by ESMA to do so.

Furthermore, the corresponding dates should be clearly mentioned in the ESMA public register or, at a minimum, ESMA should clearly indicate where this information will be made available to counterparties that should have enough time to anticipate the impacts of the clearing obligation.

**Chapter VI – Liquidity fragmentation**

***Art 1 – Specification of the notion of liquidity fragmentation***

The FBF has concerns regarding the consistency of article 1(6) of ESMA’s proposal with Art 8.4 of the level 1 text which indicates that: “*Access of the CCP to the trading venue shall be granted only where such an access would not require interoperability or threaten the smooth and orderly functioning of markets in particular due to liquidity fragmentation and the trading venue has put in place adequate mechanisms to prevent such fragmentation*”.

Does it mean that interoperability would be authorised for OTC derivative products in some specific cases? If it is not the case, the end of this article 1(6) should be deleted as follows.

“*6. Clearing arrangements referred to in point (b) of paragraph 3 may foresee the transfer of transactions executed by such market participants to clearing members of other CCPs or, without prejudice to the conditions in the second subparagraph of Article 8(4) of Regulation EU xxxx/2012 [EMIR]~~, take the form of interoperability arrangements under which the relevant CCPs agree to such arrangement and the relevant competent authorities approve it~~.*”

In any case, clarification should be provided on this topic.

**Chapter VII – Non financial counterparties**

***Art 1 – Criteria for assessing which OTC derivative contracts are objectively reducing risks***

As a general comment, the FBF favours the approach retained by ESMA fornon-financial counterparties.

However, there is no provision specifying who is responsible for establishing if an OTC derivative contract is objectively reducing risks and who is supposed to check if the total value of all OTC derivative contracts of a given non-financial counterparty exceeds or not the clearing thresholds.

In any case, a financial counterparty should be not sanctioned where it has not cleared some OTC derivative contracts with a non-financial counterparty that has declared to be below the clearing thresholds although it was not the case. Indeed, there is no way to verify if it is entering into a derivatives transaction in order to reduce commercial/treasury risk, nor to verify if it is within its clearing thresholds. Being said differently, non-financial counterparties should be responsible for determining if they are below or above the clearing thresholds and for informing appropriately other counterparties / competent authorities. This information should be provided by the non-financial counterparty before entering into a transaction.

Finally it should be guaranteed that options retained by ESMA will not create an unlevel playing between financial counterparties and non-financial counterparties which are active in commodities OTC derivative contracts.

We understand that it is not the intention of ESMA to prohibit- except for the hedging of stock option plans- the use of equity derivatives as acceptable hedge of equity stakes or other equity strategies conducted by non-financial counterparties. Therefore, the FBF proposes that the list of recognized risks “*resulting from fluctuation of interest rates, inflation rates or foreign exchange rate*” should be broadened to equity value.

An express exemption in the Level 1 text of EMIR and proceeding on the assumption that a repackaging or structured finance special purpose vehicle ("SPV") will be classified as a non-financial counterparty, it is not clear from the drafting of Article 1 NFC that the OTC derivatives entered into by such an SPV to hedge the repackaged notes or liabilities relating to a structured finance debt issuance or securitised derivatives issuance will qualify for the hedging exemption. EMSA should clarify how Article 1 NFC is intended to be applied to both orphan and consolidated balance sheet SPVs that typically enter into OTC derivatives trades with the arranging, sponsor or originating banks (the latter will invariably be classified as financial counterparties under EMIR)."

**Chapter VII – Risk mitigation techniques for OTC derivative contracts non-cleared by a CCP**

***Art 1 – Timely confirmation***

On this topic, the FBF strongly supports the EBF[[1]](#footnote-1) view as reproduced below:

“*The timing proposed by ESMA is far from existing market practices. Where a contract is not confirmed electronically, the existing timing for confirmation is at least 5 days. If ESMA insist on maintaining a rigid approach then banks would request a sufficient phase-in period.*

*Furthermore, ESMA must further clarify some provisions. It is our understanding that “confirmation” is to be 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 focuses on the key terms.*

*The present draft delegated regulation currently lacks a definition of the term “confirmation”. The term “confirmation” is, however, defined in Art. 2 (4) 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 to Annex V below. To avoid any uncertainty over the understanding of the term “confirmation”, we suggest that it is defined in line with the above described understanding and also uniformly for the purposes of all delegated regulations (ideally in a single section on definitions applicable to all delegated regulations in order to avoid uncertainties, 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 (i.e. its entering into the clearing system of a CCP) follows after the conclusion of the contract.*

*The term “electronic means” may need to be defined more clearly. Likewise, 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 taking into account the trade volume on the one hand and the cost of implementing and maintaining such system on the other.*

*In order to make the confirmation procedure feasible for all and efficient, we think the ESMA requirements need more differentiation and should take into account :*

* *the confirmation type ( electronic - paper vanilla – structured / bespoke ) as this corresponds to the degree of standardization of the underlying product*
* *the type of execution : manually or electronically*
* *the counterparty: the distinction Financial / Non-Financial is not sufficient : for example investment managers execute single block trades and need to allocate partials to individual funds. In addition, there are many small-medium entities that enter into OTC transactions with a longer confirmation process due that many times courier or personal delivery is needed, only one person (CEO) is authorized to sign it.*
* *the asset class. »*

To illustrate, the current ISDA best practices for interest rate derivatives are described in the table below:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Confirmation Type** | **Drafting** | **Execution expectation** | **Chasing** | **Escalation** |
| **Electronic** | T+1 | T+5 | T+2 | T+4 |
| **Paper ( vanilla templates )** | T+2 | T+30 | T+7 | T+21 |
| **Structured ( bespoke )** | T+10 | T+30 | T+14 | T+28 |

At last, and as already mentioned, consistency should be reached with the US regulation. On transaction reporting respect, ESMA proposes a monthly report of the number of unconfirmed OTC derivatives that have been outstanding for more than 5 business days. Knowing that a very detailed report is already produced on a monthly basis by FED 15 banks, ESMA’s requirement would mean a duplication of efforts through:

- The creation of a new report (subset of data compared to the data reported already);

- The split up of the reporting as investment firms would have to report towards the competent authority and not on a global basis (while the global view is in fact more significant).

For this reason, the FBF suggests that this report, if produced, should be acceptable to comply with the FED’s monthly report requirement.

***Art 2 – Portfolio reconciliation***

The FBF agrees with the portfolio reconciliation principles introduced by ESMA and notably for a need of regular reconciliation between counterparties. The variable frequency of the reconciliation according to the size of the portfolio is also a good approach.

Another relevant criteria to define the frequency of the reconciliation of the portfolio is its turnover (i.e. stable portfolios are being less subject to discrepancies than portfolios with high turnover).

The FBF broadly supports the proposed frequency relative to the number of outstanding transactions for performing portfolio reconciliation.

However, we would suggest adding a 4th category for very small portfolios of less than 100 swaps, to be performed on a quarterly basis.

Alternatively, confirmation matching could serve as a mechanism that will allow discovering discrepancies in trade terms for small portfolios.

We would like to point out that portfolio reconciliation is only practicable when the counterparty is using an established reconciliation tool and is able to provide their portfolio.

A sufficiently long phase-in period will be necessary to allow the required set-up of regarding valuations, standard trade representation or links with existing providers.

***Art 3 – Portfolio compression***

The FBF acknowledges that final proposals by ESMA are more reasonable than those made in the discussion paper. However it should also be mentioned that compression techniques should be only applied to all OTC derivative contracts which are already submitted to these practices and which are highly standardised (e.g. CDSs). In any case the compression process should not apply to OTC derivatives.

Portfolio compression is a valuable and viable solution, however, within certain asset classes only (highly standardized contracts in rates and credit) and within a small group of participants: to broaden it would be costly and not beneficial.

We would welcome exemptions for other asset classes (Forex, equity derivatives and commodity derivatives) for which this process is not relevant.

***Art 4 – Dispute resolution***

The FBF believes that ESMA’s proposals are not in phase with the principles which have been elaborated by the industry on this process[[2]](#footnote-2). Final rules retained by ESMA should not contradict the corresponding practices which have been defined in a way to ensure efficient investigations and timely resolution in case of dispute. A too constraining framework should not result in a decrease in the quality of dispute resolutions.

In this respect, the proposed timeframe of 5 business days proposed by ESMA to deal with disputes that are not resolved seems too short, particularly if a market polling mechanism is required. The current DRP[[3]](#footnote-3) ISDA proposal is to allow 31 days in order to allow counterparties to conduct proper investigation, consult and eliminate the "*false positive breaks*" (three levels: 1-20 days for administrative review, 20-30 days for senior consultation and then after 30 days secondary resolution).

Reporting to the competent authority on margin disputes occurs **on portfolio level, not on individual trade level** as ESMA seems to suggest: disputes can be attributable to a number of trades, where each individual trade difference is not very material, but the sum of these differences on portfolio level may be significant.

Also, it should be left to the discretion of each firm to decide on the materiality of a dispute and apply more stringent controls if they find it appropriate.

***Art 5 – Market conditions that prevent marking-to-market and Art 6 – Criteria for using marking-to-model***

No comments.

***Art 7 – Intragroup transaction notification details***

The FBF asks for more clarification on whether mirrored deals are in or out of the scope of EMIR reporting.

Regarding intragroup transactions, they can be exempted from both clearing obligations and margin requirements for non-cleared transactions, subject to some specific conditions, and notification to competent authorities. As such, art 7RM should refer to both art 11 for the margin requirements and paragraph 2 of art 4 with respect to the clearing obligation (and the scope of the requested informations should be adjusted accordingly).

**II. CCP Requirements (Annex III)**

As a preliminary comment, the FBF would like to insist on a number of CCP’s key features that need to be taken into consideration where defining the requirements they will have to comply with on a harmonised basis:

- **CCPs are market infrastructures whose primary role is to ensure the safety and stability of the financial markets in the long term.** As a result the CCPs should not be allowed to take any types of risks which are not directly associated with their activities and should not be in competition between each other;

- **Similarly the functioning of CCPs should be as simple and transparent as possible.** CCP members should have the capacity to assess the risks associated with the CCP in any type of circumstances. Therefore the CCP should have the obligation to disclose its risks model to its members in a systematic way and should not be allowed to engage in some complex operations / arrangements that could modify substantially the risk profile of the CCP.

- **Most questions addressed by ESMA in the RTSs should be considered conjointly instead of individually as long as they refer to the level of risk of the CCP.** This is notably the case on one side for issues related to margins and the default fund (as they both refer to the level of risk that is supported by the CCP members and their clients) and on the other side those related to collateral, investment policy of the CCP and liquidity risk control (as they both refer to the risk management policy of the CCP and actions to mitigate these risks).

**Chapter I – General**

No comments

**Chapter II – College**

***Art 1 – General***

No comments

***Art 2 – Determination of most relevant currencies***

The FBF agrees that the currency is a significant parameter that needs to be taken into consideration and therefore agrees with ESMA proposals.

However, in order to ensure a manageable college (i.e. avoid a too high number of participants in the College) we are of the opinion that the share of underlying products should also be considered to identify the participants to the College. Therefore we suggest that only Member States for which the relative share of underlying products exceeds 20 % of the CCP’s average end-of-day positions should be retained for the composition of the College.

***Art 3 to 9***

No comments

**Chapter III – Recognition of third country CCPs**

It should be ensured that third country CCPs have a level of safety that is similar to the EU CCPs’. As mentioned above, CCPs are market infrastructure which are key in the stability and security of financial markets.

In this respect the equivalence principles in terms of prudential requirements should be applied as well as reciprocity.

**Chapter IV – Organisational requirements**

***Art 1 – Governance arrangements***

The FBF agrees with ESMA proposals.

However, regarding the composition of the Risk Committee, we suggest that it should be clearly indicated that a majority of representatives shall be users of the CCP, i.e. clearing members to avoid a under-estimation of the level of risks of the CCP and/or a reduced quality of services provided by the CCP.

***Art 2 – Risk management and internal control mechanisms***

The FBF is of the opinion that this provision should be further developed by specifying that the CCP should impose to its clearing members to apply at least the risk calculation model (or algorithm) of the CCP in order to ensure a miminum level of consistency between clearing members in their own risk management policies. Such a principle would also ensure that clients of a clearing member benefit of the same level of security as clearing members themselves. However the relationship between a clearing member and its clients is a commercial one and as such is a banking activity which is submitted to the banking regulations. In these conditions the level of risk taken by the clearing member towards its clients is assessed by the clearing member itself accordingly to its internal risk management policy. Therefore the clearing member shall be authorised to request an additional amount of collateral from its clients that is above the amount required by the CCP.

***Art 3 to 7***

No comments

***Art 8 – Auditing***

The FBF agrees with ESMA proposals regarding the internal audit function. In the case of external auditing performed by external entities, we are of the opinion that the corresponding results should be communicated to the CCP clearing members for transparency reasons.

**Chapter V – Record keeping**

***Art 1 – General requirements***

No comments

***Art 2 – Records of data reported to a trade repositary***

The FBF believes that the 10 years retention period is fine but may not be sufficient for contracts with a longer maturity date: the retention period should at least cover the lifecycle of the contract.

**Chapter VI – Business continuity**

No comments

**Chapter VII – Margins**

*Even though it is not mentioned in this text, the FBF considers as very important that CCPs post variation margins to their clients[[4]](#footnote-4). This corresponds to the cash received from one counterpart that has to be posted to the other one. This is already the case for the futures market.*

*In addition, this would limit the liquidity trap that is going to increase in volume at CCPs levels without creating additional risks for CCPs as slippage period is already covered by the initial margins.*

*Transparency on margin requirements and valuation methodologies of CCPs is of key importance as, it will enable clearing members to assess the margin requirements and the way OTC products will be valued by the CCP.*

*When calculating portfolio margining, it is important to be able to take into consideration the instrument posted as collateral not only through standard haircuts. The correlation between the financial instrument and the underlying should be taken into account as well. For example, a call on Total with Total shares posted as collateral shall be taken into account adequately and not through simple haircuts.*

***Art 1 – Percentage***

The key priority for the determination of the confidence interval for margins is the application of a unique percentage for all types of products, and not different percentages depending on the types of products. The best way to take into consideration the differences between products in terms of risks and liquidity is actually the periods retained for liquidation which are key for the right functioning of the CCP in case of stress periods.

Differentiated confidence intervals are not appropriate mainly because it would prevent the application of cross margining between the different products cleared at the CCP level. Would cross-margining not be feasible it would result in shortage in collateral in a global environment where collateral resources are crucial.

In addition the determination of the confidence level percentage is to be considered conjointly with the level of the default fund. Where a higher confidence level is retained (i.e. higher initial margins) the level of the default fund is decreased accordingly. We consider that the use of the default fund should be limited (i.e. the amount of the default fund should be capped) as any way the access to the CCP should be restricted to financial entities which have a high financial strength and that would not endanger the smooth functioning of the CCP. Once again CCPs are market infrastructures which are key in the functioning and safety of financial markets, CCP requirements are to be defined accordingly.

**Finally it should be indicated that where a CCP revises the level of the margins, clearing members should be informed accordingly.**

***Art 2 – Time horizon for the calculation of historical volatility***

The FBF agrees with the ESMA proposal to mix stable and stressed market conditions.

For OTC derivative products, a 5-year history would make sense and is normal for OTC derivatives. However, as the CCPs have the ability to change margin levels quite rapidly, a shorter period, such as the 6 months proposed by ESMA, makes sense.

***Art 3 – Time horizon for liquidation period***

The liquidation period proposed by ESMA for OTC derivatives is not realistic at all and too much aggressive .A minimum period of 10 business days should be retained instead of 5 business days for these products. On the contrary the liquidation period for listed financial instruments should be reduced to one business day (instead of 2 business days) to be in phase with existing practices which are fully adapted for highly standardised and liquid products.

***Art 4 – Portfolio margining***

No comments

***Art 5 –Pro-cyclicality***

As a general comment on margin requirements and more globally on the risk model of the CCP, the FBF considers that the CCP should disclose its calculation algorithm to the clearing members. This requirement is the only way to ensure an appropriate level of transparency for clearing members and the capacity for those to replicate the CCP risk model on the assessment of risks associated with their own clients.

**Chapter VIII – Default Fund**

***Art 1 – Framework and governance and Art 2 – Identifying extreme but plausible market conditions***

ESMA makes reference to the correlation between markets and to market volatility. The FBF believes that these concepts should be extended to products.

***Art 3 – Reviewing extreme but plausible scenarios***

No comments

**Chapter IX – Liquidity Risk Controls**

The FBF agrees with proposals made by ESMA on this part, notably all general principles that will concur to reinforce and harmonise the framework and policies to implement efficient liquidity risk controls and the list of liquid resources which is retained by ESMA.

However these proposals will be effective only whether rules retained for collateral accepted by the CCP and investment policy of the CCP are adequately defined and prescriptive enough (see our comments on these chapters below). A key point in this respect is about the sufficient level of diversification of entities which are used by the CCP for the deposit of cash and securities that have been received as collateral.

**Chapter X – Default Waterfall**

No comment.

**Chapter XI - Collateral**

While we understand the requirement for concentration limits at the level of the CCP, it is of the utmost importance that the collateral policy of the CCP is known well in advance in order for clients to be able to source adequate collateral. Therefore, concentration limits at CCP’s level and not for each counterparty will be difficult to implement.

CCPs should accept as collateral assets denominated in the same currency of the underlying instrument, as well as assets denominated in a different currency than the underlying instrument, namely currencies of the European Union, USD, GBP, EUR, JPY, or any other currency the exchange risk of which the CCP is able to manage."

Regarding the type of collateral that can be accepted by the CCP, the FBF believes that cash should represent a important portion of collateral received by the CCP (need for liquidate positions promptly in case of default) but collateral should not be restricted to cash and should be extended to securities provided that they are of high quality and highly liquid. Rating of the security and integration of the security in a widely-used index are criteria that can be used for identification of suitable securities.

**Other types of assets, notably gold or any other physical assets, should not accepted.**

Beyond the ESMA proposals regarding the types of assets that are to be accepted as collateral by the CCP, the objective is to ensure that assets posted as collateral will be available in a very prompt way (not to say immediately) in case of liquidation.

* **Where cash is posted as collateral**, the following rules should prevail:

- for cash denominated in the principal currency of the CCP, it should be deposited in a Central Bank account;

- for other currencies, the same principle applies and where it is not possible to deposit in a Central Bank account, there should be some rules on which types of entities can be used by the CCP and some diversification rules to reduce the risk of the CCP. The CCP should be allowed to deposit cash only which EU regulated credit institutions (which comply the EU legislation applicable to these entities). The use of third country credit institutions should be limited to very specific cases where no other option is available and these third country credit institutions should be submitted to rules equivalent to those which prevail in the EU (notably regarding the prudential constraints).

In any case the proportion of cash non-deposited in a central bank account should be capped.

* **Where securities are posted as collateral at the CCP**, these securities should be appropriately segregated to guarantee their effective protection in case of default. We suggest the application of the following rules:

- Securities should be deposited in a CSD where it is authorised by the local jurisdiction of the CCP. An account should be opened in the name of the CCP in the CSD or in the name of the custodian which operates on behalf of the CCP;

- Otherwise, where deposit in a CSD is not possible, securities should be deposited with custodians with a diversification principle, i.e. no more than 40 % of securities are deposited with the same custodian. This rule contributes to reduce the risk resulting from the failure of a custodian.

**Regarding haircuts**, we consider that the rating of the clearing member should be taken into account where defining the haircuts to be applied.

**Chapter XII - Investment Policy**

ESMA should take into account ratings/credit spreads criteria on their bond portfolios. On this respect, the retained wording “*bearing minimal credit risk*” is not explicit enough.

In addition a CCP should not be authorised to enter into derivative transactions even in very restricted circumstances as the CCP should not be exposed to additional risks which are not typical of the clearing activities. In case of liquidation requirements such transactions could delay the capacity of the CCP to meet its requirements and consequently raise additional issues.

**Chapter XIII : Review of Models, Stress Testing and Back Testing**

**Art 7 : Stress testing - total financial resources**

The stress testing program mentioned in Article 7, §2, should ensure that the margin and default funds are sufficient to cover the default of the two largest clearing members, as opposed to just one. This is standard and should avoid multiple additional default fund assessments.

**III. TRADE REPOSITARIES (Annex V)**

As general comments, the FBF believes that many areas are still not covered by ESMA proposals.

**Main ones can be listed as follows:**

* ESMA does not indicate how a trade repository (TR) will deal with situations where information sent by each counterparty do not match (i.e. where the same TR is used by both counterparties) beyond the use of global standards such as LEI, USI, UPI… ;
* Similarly, where counterparties have to report to different TRs (i.e. counterparties are not submitted to the same regulation as there are not located in the same jurisdictions), how will TRs reconcile the two flows of information and what happens if these two flows are not similar?
* Who will be in charge of the control /reconciliation of data reported to the TR?

If the reporting to TR can be delegated to a third party, does it create an issue if a counterparty delegates the reporting to its custodian/depository to the TR, itself reporting to another TR (very concretely a GTR which reports to local TRs)?

* **Aggregating / Accessing data:**

A clear definition is needed of the “*position data*”, as well as clarification on positions should be calculated.

* **Interim Identifier:**

The Dodd Frank Act also plans to put in place an “*interim identifier*” called the “*CFTC interim compliant identifier*”.

Will it be possible to use the same interim identifier like the one created for Dodd Frank Act response?

* **Reporting assignment**

At the time being, we still need further details on the reporting assignments i.e. clearer designation of reporting assignee for all cases. Is it logical to require the same type / frequency of reporting requirements irrespective of the type of market participant and the significance of its derivatives business? We would suggest the introduction of reporting thresholds in certain cases.

**Art 1 – Scope**

**No comment.**

**Art 2 – Definitions**

Maybe the definition of “*taxonomy*” and “*novation*” should be added.

**Art 3 – Details to be reported**

The end of §.5 is not clear: what is the exact meaning of “to ensure that the common data is agreed between both parties to the trade”? Does it mean that both counterparties have to reconcile their data prior to the transmission to the TR(s) (in the case where each counterparty send its own flow of data).

**Art 4 – Reporting by a third party**

The FBF would like to point out that the reporting of “*Collateral type*" is a new requirement, i.e. this field is not included in the Dodd-Frank reporting requirements.

**Art 5 – Cleared trades**

The requirement made in §2 (“*Where novation occurs before reporting to a trade repository, a report shall be made on the basis of the terms of the transaction before novation and indicating that it has been cleared*") is not clear in terms of roles and responsibilities of the investment firms vis-à-vis the CCP and potentially carries considerable operational impacts.

**Art 6 – Reporting of collateral**

ESMA address the fact that collateral can be reported only on a portfolio basis. Corresponding operational challenges are to be further reviewed for additional comments.

We would like to point out that the reporting of “Collateral type" is a new requirement, i.e. this field is not included in the Dodd-Frank reporting requirements.

**Art 7 – Reporting log**

**No comment**

**ANNEX VI: Draft Implementing Technical Standards on Trade Repositories.**

**Art 5: Reporting of collateral**

Reporting the specific contracts over which collateral has been exchanged raises some serious practical difficulties. As the collateral is managed on a portfolio basis, collateral cannot be assigned back to a specific trade. Also, different types of collateral can be exchanged on a single portfolio.

Providing Mark to Market values of contracts on a structured trade involving several legs may not always be possible.

**Table 2 Common Data page 175**

**Field 63 (page 175) “Action type” = N=New, M=Modify, C=Cancel.**

The FBF suggests adding another status which could be the fact that transactions are “**Terminated**” in order to highlight the transactions terminated before the initial maturity date (Early terminations for example).

**Field 63 (page 175) “Action type” = N=New, M=Modify, C=Cancel.**

The FBF suggests to add another status which could be the fact that transactions are “**Terminated**” in order to highlight the transactions terminated before the initial maturity date (Early terminations for example)

1. See EBF response to this consultation paper. [↑](#footnote-ref-1)
2. In collaboration with ISDA. [↑](#footnote-ref-2)
3. Dispute Resolution Process (DRP) [↑](#footnote-ref-3)
4. Symetrical variation margins. [↑](#footnote-ref-4)