Federation of Finnish Financial Services

RESPONSE

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Federation of Finnish Financial Services (hereinafter "FFI") represents banks, insurers, finance houses, securities dealers, fund management companies and financial employers operating in Finland. Its membership includes employee pension, motor liability and workers compensation insurers, all three providers of statutory insurance lines that account for much of Finnish social security. The Federation has about 460 members who employ a total of 43,000 people.

ESMA
European Securities and Markets Authority
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DISCUSSION PAPER ON DRAFT TECHNICAL STANDARDS FOR THE REGULATION ON OTC DERIVATIVES, CCPS AND TRADE REPOSITORIES

The Federation of Finnish Financial Services (hereinafter "FFI") welcomes the opportunity to respond to the ESMA discussion paper on Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories.

GENERAL REMARKS

- We appreciate the efforts to avoid any double reporting obligations. FFI agrees that the reporting requirements for derivatives contracts should be similar to requirements introduced in MiFID trade reporting. We do not support any double reporting obligations when there is already a well-designed trade reporting system in function. Thus it would be beneficial to found on the same basis than recent MiFID trade reporting requirements do.

- With regard to a CCPs investment policy (article 44), it needs to be confirmed that a CCP is not allowed to speculate with the assets received in a way which could have a negative impact on the sustainability of the CCP. Further, it needs to be required that the capital a CCP receives as initial or variating margin always needs to be invested in a way that the profits are paid back to the Clearing Members.

- We would also like to stress the importance of collateral and invocation of different kinds of collateral. Many companies that use derivatives in their activity are in possession of collateral other than the "usually recognised financial collateral" (liquid securities and cash). This collateral, being for example land, real estate, machinery etc. should be considered to be

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accepted as collateral in the future. It should be noted that not even all the listed companies have a liquidity buffer to CSA- kind risk mitigation factors.

RESPONSES TO SPECIFIC QUESTIONS

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

First of all, the FFI sees it important to make sure that these rules do not lead to any conflicts between the various sets of legislations, e.g. EMIR and Dodd-Frank Act. From a market participants' point of view any situation where a transaction could be required to be cleared and reported in more than one place must be avoided.

We would appreciate any concrete examples of such cases where the OTC contract has been concluded with a third country entity and where the counterparty shall have a clearing obligation. This example should as well cover any other obligations that the counterparty may have to fulfill.

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

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

In our opinion, the preferred route should be a structure where the CCP setup is of an agency nature rather than a principal to principal nature. This would be for instance a situation where a client clears transactions for its own client.

Such an approach would seek to minimize the scope of indirect contractual arrangements which in turn could prove to be problematic from a legal perspective, especially with regard to portability issues and segregation in case of a clearing member's bankruptcy.

Q4-Q6: Clearing obligation procedure and notification from the competent authority to ESMA

No comments at this stage.

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

With regard to standardisation, the FFI supports the use of standardised contractual terms and operational processes when possible. However, we would appreciate the possibility to choose from different documentation (not only from e.g. ISDA documentation) whenever the documentation used fulfills the requirements that are set to standardised documentation.

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In our opinion, it is very important to take into consideration the differences in liquidity and volume by currency. As an example, Interest Rate Swaps (IR) as a product class is eligible for clearing. However, liquidity in NOK IR Swaps is poor whereas liquidity in EUR IR Swaps is good.

When the classes of transactions that should be subject to the clearing obligation are assessed, the fact that some transactions are made within classes that are not suitable for clearing or that are even impossible to clear needs to be considered. One example where the instrument-based approach does not work is the IR swaps made for Nordic covered bonds. In their essence, they are quite standard products but which, due to requirements under national law and by rating agencies have terms and conditions that do not fit into the clearing system (posting of one way collateral, no possibility to terminate the contract in case of bankruptcy etc.). The clearing obligation for covered bonds would thus lead to a double treatment which needs to be avoided.

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

The FFI would like ESMA to clarify whether the public register includes information on the classes of OTC derivatives exclusively. In addition, it is at this stage unclear whether amortized transactions are subject to the clearing obligation and whether the public register should also include information on that kind of transactions.

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

Yes, the data seems sufficient.

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

It is very important that the definition is sufficiently broad in order to capture all risk mitigating transactions that are currently used by financial counterparties. However, it is equally important to make sure that the definition captures future needs as well.

Possibly the ESMA should look at the opposite and aim to define speculative transactions from which one could conclude that non-speculative transactions are risk mitigating.

Finally, the financial counterparty should have obligations to non-financial counterparties only when there is a specific agreement between them concerning reporting, defining the nature of transactions to be hedging or non-hedging or monitoring of the threshold.

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

As a starting point, the threshold that is now being set for the clearing obligation should be functional and appropriate. Based on this assumption, setting a threshold for the clearing obligation is extremely difficult since the nominal amount of a derivatives contact is not a proxy for the true risk. As an example, a 1bn EUR 1yr swap has a large notional value but contains only a small risk little risk whereas a 50m EUR (notional) in a 30yr leveraged, structured product has a small notional value but can be quite risky. When this fact is combined with possibilities to distribute risk between legal entities, the task seems even more difficult.

Therefore we suggest that ESMA takes an approach that relies on the net positions as the notional amounts in opposite transactions are not straight forwardly additive. Another key element in the approach taken should be that the threshold should represent the systemic significance of the contract, thus fulfilling the initial aims of the regulation. Based on this, the threshold could be set to be a transaction with a net worth of 500 million euros. This threshold should in our opinion be linked to the recognising of a derivatives position with a hedging nature. A simple way to identify this link would be that the risk management of a non-financial counterparty would be simply linked to such a derivative contract.

If ESMA still considers to use the nominal value as a threshold, it should be high enough so that it would not create unnecessary processes and costs to banks' clients. Both approaches however need, as ESMA recognizes, gathering of more data before a threshold can be set. It could even be valuable to consider an approach where the threshold would be based on the amount of contracts that would lead to significant systemic risk. This approach can be justified with the reporting obligation of all transactions to competent authorities which ensures that the systemic risk cannot cumulate without the authorities having the information.

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

There is a clear difference between electronically executed, processed or confirmed transactions, and in general, transactions which are electronically processed are able to be confirmed more quickly. However, the concept of *electronically* is a bit unclear and thus we have two different options for an appropriate timing.

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If "electronically" is meant to be understood as automatically it would be more appropriate with a one hour timeframe to enable dealers to deal-capture, validate transactions and dispatch confirmation (38b). On the other hand, if "electronically" implies use of an electronic system but some manual updates and controls are required during the process, the timeframe should be several hours.

Based on our understanding, the confirming obligation would be binding on both parties to a transaction. The suggested timeframes, therefore, could be more challenging for some counterparties (for example NFCs) than for the others and should thus not be set too tight. It should be noted that at the moment transactions between non-financial counterparties or small financial counterparties are made by telephone. Thus it is indispensable that the proposed timelines, especially when set too tight, will lead to changes in the IT-systems both in the financial institutions and in the non-financial institutions, in their role as an end-user.

It should be added that not all transactions can be sufficiently confirmed electronically but require a process of manual work to confirm the transaction such as the preparation of bespoke confirmations in order to cater for the technical details and boiler plate terms and conditions. This is a process which for obvious reasons cannot be concluded within the timeframes as set out in the discussion paper. As an example, a big part of OTC derivatives transactions done in a hedging purpose is still sent via fax or post. Thus the relevant timeframe to confirm these transactions should be three working days after the terms of the contract have been agreed. This timeframe would only apply to the sending of confirmation but when it comes to the receiving of a signed transaction, the timeframe should be significantly longer, for example two weeks.

Finally, we believe that the timeframes should take into account the various time zones in the European Union. As an example, transactions in Helsinki can be made two hours before the London market opens and thus the markets close two hours before than markets in London. Based on this fact, adequate confirmation time should be set at least to the next calendar day.

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

For plain vanilla derivatives, the period of one month from the trade date should be sufficient for reporting unconfirmed OTC derivatives to the competent authorities. The participants should be able to use current reporting systems as it would pose a heavy burden for them to build a new reporting system.

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

As a starting point, the FFI believes that marking-to-model valuation technique should not be regulated as a part of CCP requirements as it is already regulated in other legislative dossiers, such as IFRS. Further, individual risk valuation techniques should not be taken to the board for their approval. The board is responsible that the undertaking has effective procedures for risk assessment but it should have to consider single risk valuation techniques. The market

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inactivity should be defined both in terms of transaction per time unit and in terms of tradable size.

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

Please look at our response to Q14.

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

At this point it is unclear what is considered to qualify as sufficient reconciliation of non-cleared OTC derivative contracts. In our view, it would be sufficient that a financial counterparty delivers a list of outstanding trades regularly to its non-financial counterparty and the non-financial counterparty has an opportunity to remark. In connection with this the turnover and the type of trades in the derivatives exposure between parties should be taken into account. If the parties trade only irregularly and in plain vanilla derivatives, it should be considered that reconciliation doesn't actually fit its purpose.

It should be noted that if the portfolio is not reconciled due to posted collateral there will not be any reconciliation after confirmations have been exchanged. However for many transactions the payments during the transactions' lifetime will imply recognition of the transactions itself although remaining amortization and maturity date can differ.

For collateralized portfolios the requirements on frequency seem fine. A suggestion for the X could be 50 trades. We would though prefer not to have a frequency dependent on volatility but instead to have a frequency dependent on size, dispute and aging. This way timely investigation of sudden new issues would be secured and the need for reconciliation can be determined already in the normal process of handling the margin calls.

Given the opportunity, we would like to express an idea to impose a rating trigger on the frequency, where:

- all portfolios above 300(100) transactions should be reconciled daily, and
- if the portfolio is less than 300(100) transactions, then the frequency will be determined by the rating of the counterparty (Daily, Monthly, Quarterly or Yearly).

Finally, it should be noted that all counterparties are not able to provide their own valuations on the OTC derivatives. The ability of "capable" counterparties to do business with these counterparties should not be restricted following the fact that all counterparties cannot comply with these requirements.

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

We do not support a requirement to back load transactions from before the cut-off date. In addition, we would like to question whether it is possible to establish a portfolio compression obligation in the technical standards given that this mandate is not clearly stated in the regulation itself.

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

The concept of legal settlement, third party arbitration and/or a market polling mechanism's according to paragraph 54c remains unclear to us.

If legal settlement means that the trades should be unwound, and if resolving means that the dispute no longer exists, then this procedure is not possible for our members. Disputes due to e.g. different FX rate fixings or timing of EOD prices on underlying indices cannot be resolved, and as there are no limitations to for example the sum of the dispute, this requirement will not be enforceable in practice. Further, it should be considered whether the provisions in the ISDA agreement on this area are sufficient to cover this last requirement.

Otherwise most of the members comply with the requirements. They are already monitoring the disputes, their aging and have written procedures in place on how to resolve the disputes that may arise. However, it should be noted that these requirements should not pose additional burden on market participants and authorities on reporting and on setting up new processes.

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

In our opinion, the concrete means to manage disputes and the incorporation of these rules could to a large extend be handled by ISDA even in the future.

The ISDA Agreement together with its definitions does recognise the use of Calculation Agent (including dispute rights/joint calculation agent and fall back mechanics) which constitutes a well-recognised contractual way in which disputes are resolved. This does not, however, address or solve the problem relating to which method the calculation (or replacement) agent shall resort to when making the determination. For instance, many different sources, timings and methods are used in the market. On the same topic, we note that legal settlement is in principal not something that can be counted towards a list of sufficient ways in which to deal with a dispute.

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

Firstly, we would like ESMA to give a clear definition of what would constitute a dispute in this sense. In some cases there are discussions on minor details in a confirmation which are not enough to turn the transaction into a dispute.

It should be noted that it can be very sensitive that a dispute exist, and the reason for the dispute could be even more sensitive (e.g. authority issues). Thus the information should not in any case be made public and the competent authority should handle such information very carefully, if at all. Neither should there be an incentive for financial institutions to settle a dispute within a very short timeframe as this will put them in a worse situation since the incentive may in many cases be that disclosure cannot be allowed. There could also be situations where the contractual relationship with a particular counterparty does not allow for disclosure (e.g. arbitration clauses with non-disclosure undertakings).

As a general remark, this is yet another reporting obligation that is not provided in EMIR regulation and it should thus be set to a level where it will not be triggered very often, due to the above reasons. In our view, the higher or longer the threshold is the better.

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

In our opinion, the reporting requirements for derivatives contracts should be similar to requirements introduced in MiFID trade reporting. Any double reporting obligations should be avoided, especially when there is a well-designed trade reporting system already in function. Thus we see that when ESMA analyses OTC derivatives reporting obligation for regulatory technical standards and implements technical standards it would be beneficial for all to found on the same basis than recent MiFID trade reporting requirements do. The FFI appreciates ESMA's efforts in this respect.

Further, the details should base on the specified use and need of the competent authorities in a way where they shall have real relevance to the competent authority without adding unnecessary work.

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

The need to publish any transaction details to the public needs to be carefully considered. Any other information than the existence of a transaction as such should be given only to the competent authorities. Further, there could even be situations where a disclosure of an intra-group transaction to the public may be in conflict with rules on non-disclosure of information for publicly listed companies.

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

There are many reasons, especially financial stability and prudential supervision, that would recommend tying up liquidity in CCPs. However, it should be noted that taking this requirement too far, taking into account even the other legislations should as the CRD, would lead to market inefficiencies where the market participants would not have enough liquid assets to provide for market making activities and/or efficient collateral management.

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

Taking into account the purpose of the regulation and the implementing technical standards, we believe that starting to name exact officers in a CCP goes too far in details. It should be sufficient that each CCP will name a body responsible for these actions to the competent authority but that the technical standards would not touch on the names of these positions.

Q25-Q26 on Organizational requirements for CCPs regarding conflict of interests and reporting lines

No comments at this stage.

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

The existence of such criteria is important taking into account the vital role of a CCP in the market.

Q28-Q40 on Organisational requirements, record keeping, business continuity, margins and default fund

No comments at this stage.

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

We would not see a need for a CCP to maintain a minimum amount of liquid assets in cash taken that it maintains a sufficient amount of other highly liquid assets.

Q42-Q43 on Default waterfall

No comments at this stage.

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

The terms "highly liquid" and "low credit risk" in paragraphs 118 and 120 need to be very carefully defined.

Q45-Q46 on Collateral requirements

No further comments at this stage.

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

We fully support the conservative approach in setting the applicable haircuts to avoid any market disturbances. “Currency denomination” should also be used as a factor in determining the haircut levels.

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

The same criteria that have been used for defining the haircut levels in the first place should be used for the on-going re-assessment as well.

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

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

We do not support the requirement to provide a minimum percentage of collateral to CCP in cash. This requirement could lead to market inefficiencies as described in question 23. The requirement to deposit a minimum amount of cash as collateral to a CCP will add an additional risk element that should not be imposed on the market participants. This requirement will reduce the amount of liquidity that is readily available for the members for other purposes. It could be assumed that the CCPs would resort to the option to require cash collateral in a situation of stress. Since the CCPs are linked to each other, this could easily happen in a larger

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scale and across a number of systems, thus leading to a situation where the liquidity would be soaked into the CCPs in the form of collateral.

Taking the above scenario into account, we propose that the ESMA does not define such a minimum percentage. We of course understand the need for CCPs to receive collateral in a way that can be easily converted into cash but believe that it is sufficient and better for the risk management and functioning of the markets to require highly liquid instruments (that can be converted into cash over one business day).

Q51-Q54 on Investment policy

No comments regarding these questions.

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

If possible without jeopardising the possibilities for a CCP to maintain the collateral, it should be considered if the possibility to deposit the instruments with a credit institution could be removed. The possibility could on the other hand be maintained, if it can be made clear that such collateral can be segregated in the event of a bankruptcy of that credit institution.

Q56-Q68 on Concentration limits, review of models and testing

No comments at this stage.

As a general comment to the following questions, Article 6 applies to "any derivative contacts", which would include also exchange traded contracts. The discussion paper does not take this point into consideration and we propose that they are considered in the official consultation.

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

It is important that the new reporting is a supplement to the MIFID transaction reporting of OTC derivatives. This means that the industry does not have to report the same transactions into two different places. We see no need for a required ARM authorization as the most appropriate solution would be to expand the scope of the current MiFID transaction reporting into covering the OTC derivatives as well.

Further, the proposal to split the counterparty data and the common data into two different categories only adds unnecessary complexity to the set-up.

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

The number of fields should answer to the specific needs of the authorities and focus on the fields that are valuable to them. The fields Name, Domicile, Corporate sector of the C/P should be optional, when a SWIFT BIC or a common client code is available as it already identifies the party in a sufficient way. The definition of a non-EEA counterparty should also be clarified. The Financial or Non-financial nature of C/P is redundant when the industry/sector code is available. Venue of execution and type of venue of execution should not include RM or MTF since only OTC derivatives is in the scope.

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

In case of long chains this is solved by several transactions reported by the different parties involved in the chain. The very complex situation for some counterparties including funds needs to be taken into consideration. In certain situations, the personality of the beneficiary might be obvious. However, when the parties need to cover a very broad set of beneficiaries, including shareholders in a fund, they will not be able to meet the requirements. Consequently, the reporting obligation needs to be very narrow and aim at clear structures where there is a direct beneficiary and the structure as such is set up for the purpose of the beneficiary carrying out the transaction via a vehicle of some kind.

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

The identity of the client is known to the investing firm and could in our opinion be informed upon request.

Q73: What taxonomy and codes should be used for identifying derivatives products when reporting to TRs, particularly as regards commodities or other assets for which ISIN cannot be used? In which circumstances should baskets be flagged as such, or should their composition be identified as well and how? Is there any particular aspect to be considered as regards a possible UPI?

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

It would be very costly to change all deal capture systems/processes into including a new agreed trade ID. This task could be handled and the ID number provided by the TR. Since a growing number of instruments will be CCP cleared in the future, the need for such a set up will reduce over the years to come. In our opinion, the few cases where the given trade is reported to two different trade repositories will not justify the extra costs that would be placed on the reporting firms.

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

According to our knowledge, extracting final customer price from mid-market price may not constitute meaningful information to regulators since it cannot be compared between institutions. This is due to the fact that institutions use different methodologies on how to e.g. build a yield curve or model counterparty risk.

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

Given the vast amount of different derivatives products, the granularity level should be at a fairly low level, e.g. maturity, notional, market value/mark-to-model, floating rate receiver.

Q77: Are the elements in the attached table appropriate in number and scope for each of these classes? Would there be any additional class-specific elements that should be considered, particularly as regards credit, equity and commodity derivatives?As regards format, comments are welcome on the possible codes listed in the table.

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

Daily reporting would require significant IT investments both in financial and in non-financial institutions. In addition, we would like to question whether daily reporting would really be a relevant reporting frequency for most of the non-financial derivatives end users.

Q79-Q81 on Reporting by third parties and application for registration

No comments at this stage.

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RESPONSE

Elina Kirvelä
19 March 2012

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

We believe there should be a high-level of aggregation when disclosing data to the public. This aggregation should ensure that the transparency requirements do not on one hand harm market liquidity in certain assets classes and on the other hand harm funding cost for issuers (sovereign states, corporates and retail).

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

-

Yours faithfully

FEDERATION OF FINNISH FINANCIAL SERVICES

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