LCH.CLEARNET

Your Ref: ESMA/2012/379

European Securities and Markets Authority
103 Rue de Grenelle
Paris
France

5 August 2012

Dear sirs,

Draft Regulatory Technical Standards on OTC derivatives, CCPs and Trade Repositories

This letter provides the response of the LCH.Clearnet Group ('LCH.Clearnet') to ESMA's Consultation Paper (ESMA/2012/379) on 'Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories''.

LCH.Clearnet is the world's leading clearing house group, serving major international exchanges and platforms, as well as a range of OTC markets. It clears a broad range of asset classes including: securities, exchange traded derivatives, commodities, energy, freight, interest rate swaps, credit default swaps and bonds and repos; and works closely with market participants and exchanges to identify and develop clearing services for new asset classes. LCH.Clearnet and its OTC derivatives clearing services were briefly described in our response[1] to ESMA's earlier Discussion Paper.

Key concerns

We strongly support ESMA's goal of making financial markets more robust and increasing the stability of financial markets by raising European prudential standards for CCPs. This is particularly important given the impending legal mandate for the clearing of certain OTC derivatives. We have concerns that some of the proposed rules run counter to this policy goal of stability. We summarise these briefly below before addressing the proposed rules in more detail.

[1] Published at
http://www.esma.europa.eu/system/files/esma_feb2012_consultation_response_final.pdf

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- Dedicated Own Resources. ESMA proposes a requirement that a CCP should use dedicated own resources (DOR) to an amount equal to 50% of its capital requirement to cover a member default after using the defaulting member's own resources but before using the resources of non-defaulting members. We believe that such a high amount of DOR would run the risk of diluting a key incentive on members to participate in the default management of an OTC position. In addition, for a CCP to potentially lose a significant part of its capital base on a member default would challenge its viability, create substantial undesirable systemic risk, and require recapitalisation at a time its shareholders, which may be substantially its members, may be able to least afford it. We believe that a more risk based and proportionate approach would be to link DOR on risk capital alone (excluding capital for wind down) and to set DOR at 10% of this risk capital.

- Dedicated Human Resources. The proposed rule can be read as requiring a group containing more than one CCP to duplicate each function in each jurisdiction, as resource could not be shared between them, and would require an employee to be 100% dedicated to a single CCP. There are advantages in sharing resources because it is more efficient, mitigates operational risk, and enables people to back each other up more easily. For example, there could be considerable benefit for business continuity arrangements in cross-training employees between CCPs in order to ensure that both human and system resources are available for disaster recovery. We believe that CCPs should have the flexibility, taking into account their size and scope, to determine which other functions require dedicated resources as well as the levels/hierarchy of staff that need to be dedicated. Generally, we do not see any situation where staff other than Heads of Risk, Compliance and Technology would need to be duplicated.

- Separate Boards. The proposed organisation requirements suggest that CCPs that are part of a group would need to have separately composed Boards. We do not see the rationale for this proposal as it would mean that such CCPs would lose the coherence of a coordinated approach to clearing a range of products across a range of markets.

- Margin requirements. We are concerned that the level of prescription envisaged by ESMA could prevent more risk sensitive approaches to risk management. In particular, we believe the rules are over-prescriptive given the range of instruments with differing characteristics that CCPs clear. The proposals are only appropriate in the context of the simpler margining algorithms in place for example for exchange-traded derivatives and are not applicable to the advanced models used for OTC markets. We believe that CCPs should be able to select their own lookback periods for the various instruments that they clear. In addition, they should be able to define an appropriate margin methodology to capture the actual margin offsets consistent with a robust default management process.

- Use of derivatives. The proposal limits CCPs' use of derivatives to default management. However, use of derivatives is a vital part of a CCPs' risk management toolbox, particularly with respect to FX. CCP cash margins are often received in several currencies. However, there may be a shortage of high grade collateral in the associated currency. Accordingly, there may be a necessity to use FX to transform currencies received into other currencies where there is a deeper pool of liquid high grade collateral. We believe the rules should allow the prudent use of derivatives to manage FX and interest rate risk.

Detailed comments

<u>Draft Regulatory Technical Standards on OTC derivatives</u>

Chapter II – Indirect Clearing Arrangements (ICA) – EMIR Article 4

We suggest that it is made explicitly clear that "*this Chapter applies only in respect of OTC derivatives that are subject to the clearing obligation, and not to all clearing activities of a CCP"*, i.e. that clearing members and CCPs are not obliged to offer indirect client clearing arrangements for all products that they clear.

Obligations of clearing members and clients in an indirect clearing arrangements (Article 4 ICA)

6. In circumstances where the positions and assets of indirect clients cannot be successfully transferred, the clearing member shall offer to hold directly the positions and assets in an equivalent account with the CCP for a period of at least 30 days and on reasonable commercial terms. These terms shall be specified in advance as part of the contractual relationship between the clearing member and the client.

Paragraph 6 requires a clearing member to hold directly the positions and assets of indirect clients at the CCP for a period of 30 days (presumably from the date of the client's default) if they cannot be successfully transferred. If the clearing member fails to perform its obligations to the CCP, CCPs will have to manage the market exposure to which they will be exposed for these accounts for a further 30 days beyond the relevant holding period. It should be clarified that in this case "*the clearing member remains liable to perform its obligations to the CCP in respect of these positions"*.

9. A client that provides indirect clearing services shall request the clearing member to open a segregated account at the CCP. The account shall be for the exclusive purpose of holding the assets and positions of its indirect clients. The client shall not be required to disclose information on individual indirect clients to the clearing member, except for the purposes specified in paragraph 7 or in the event of default. In the event of default, all information held by a client in respect of its indirect clients shall be made immediately available to the clearing member.

In paragraph 9 it should be clarified that "*there is no obligation on a clearing member to open an individual account at the CCP in respect of an indirect client".* Members and CCPs may of course provide such a facility if they choose to.

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Chapter VI - Liquidity fragmentation (LF) – EMIR article 8

Specification of the notion of liquidity fragmentation (article 1 LF)

3. Access by a CCP to a trading venue which is already served by another CCP does not give rise to liquidity fragmentation within the trading venue if, without the need to impose a requirement on clearing members of the incumbent CCP to become clearing members of the requesting CCP, all participants to the trading venue have access, directly or indirectly, to either: a. at least one CCP in common; or b. clearing arrangements established by the CCPs.

We welcome the fact that ESMA does not propose to set a specific threshold for market fragmentation and that it is considering liquidity fragmentation on a single venue as opposed to multiple venues.

However, we believe that ESMA's proposal does not account for one important scenario. As mandatory clearing comes into force, it is possible to envisage a scenario where a Trading Venue serves two CCPs: CCP 1 and CCP 2. Suppose a Market Maker provides prices for say 5 year CDS on underlying X, and suppose the Market Maker is able to clear at both CCPs but can clear at lower cost at CCP 1 than CCP 2 (for reasons including incremental initial margins, default fund contribution, regulatory capital, clearing fees etc). Therefore, it offers a better price on this 5 year CDS if the transaction is cleared on CCP 1 than if it is cleared on CCP 2. Faced with this choice, counterparties are free to factor their own costs (as above) into deciding which offer to accept. Where their own costs are sufficiently lower to clear on CCP 2 they may still elect to transact at the higher execution price. Equally important, a new counterparty which cannot access CCP 1 but can access CCP 2, to which all participants of the trading venue would not necessarily have access, would now be able to add its liquidity to this trading venue. As a result, there would be no reduction and potentially an increase in liquidity at the trading venue, while market-maker and counterparty are able to deal mutually preferred transactions.

In the case no interoperability arrangements are in place between two CCPs, the drafting proposed by ESMA would not allow such a situation to happen since all the participants would need to have access to a common CCP. We do not believe that this was intentional as the scenario described above would not reduce the liquidity on the trading venue. We propose the alternative drafting below.

*!3. Access by a CCP to a trading venue which is already served by another CCP does not give rise to liquidity fragmentation within the trading venue if, without the need to impose a requirement on clearing members of the incumbent CCP to become clearing members of the requesting CCP, ~~all participants to~~ **counterparties to a transaction executed on** the trading venue have access, directly or indirectly, to either:*

a. at least one CCP in common; or

b. clearing arrangements established by the CCPs."

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<u>**Draft Regulatory Technical Standards on CCP Requirements**</u>

Chapter IV – Organisational Requirements – EMIR Article 26

Governance Arrangements (Article 1 ORG)

Human Resources

5. A CCP that is part of a group shall take into account any implications of the group for its own governance arrangements including whether it has the necessary level of independence to meet its regulatory obligations as a distinct legal entity and whether its independence could be compromised by the group structure or by board members also being members of the board of other parts of the same group. In particular, such a CCP shall consider specific procedures for preventing and managing conflicts of interest including with respect to outsourcing arrangements. Without prejudice to outsourcing arrangements, a CCP shall have its own dedicated human resources which are not shared with other group entities.

The proposed rules contain a provision which states "...a CCP shall have its own dedicated human resources which are not shared with other group entities". If taken literally, this would require a group containing more than one CCP to duplicate each function in each jurisdiction, as resource could not be shared between them, and would require an employee to be 100% dedicated to a single CCP. We do not believe that this was the intention of the regulatory draftsman. The Level 1 text requires that a CCP "shall employ appropriate and proportional systems, resources and procedures" (EMIR 26.3).

We believe that the intention of EMIR is to ensure that a CCP can run its critical functions independently and to avoid a conflict of interest. We agree with the view that there should be dedicated Heads of Compliance, Risk and Technology in each jurisdiction but we would not support a blanket requirement for dedicated resources in other functions such as Human Resources, Treasury, Finance or Sales. Instead, we believe that CCPs should have the flexibility, taking into account their size and scope, to determine which other functions require dedicated resources as well as the levels/hierarchy of staff that need to be dedicated. Generally, we do not see any situation where staff other than the Heads of Compliance, Risk and Technology would need to be duplicated.

The rules around dedicated resource do not need to be as stringent for a horizontal CCP-only group because there is far less likely to be a conflict of interest across a horizontal when compared to a vertical group. Indeed, there is additional resilience built in by having dual expertise and back up, such that an arrangement of this nature should strengthen both CCPs' risk management capabilities.

There are advantages in sharing resources because it is more efficient, mitigates operational risk (because there would be greater harmonisation) and it enables people to back each other up more easily. It also reduces "key person risk" in that it encourages the sharing and expertise amongst staff. Indeed the experiences of handling recent defaults showed that increased teamwork across jurisdictions and greater harmonisation brings benefits. Under normal operating conditions it is also beneficial in facilitating the pooling of knowledge of risk factors across separate CCPs.

Article 35 of EMIR allows operational functions, services or activities to be outsourced provided the CCP remains fully responsible for discharging its obligation under EMIR. We understand that this means that for example project development, Human Resources administrative services, legal services and many finance functions could therefore be outsourced. We therefore do not understand why ESMA proposes rules on Governance Arrangements that would constrain the use of outsourced resources in a same group. We also do not feel it is appropriate that CCPs would be the only financial industry participants that are constrained in terms of the sharing of group resources. This limitation does not apply to banks, fund managers, insurers, etc.

In contrast, sharing of human expertise across a group should be encouraged. It would be unnecessarily wasteful if a staff member with particular expertise in a given area could not be leveraged for the benefit of other CCPs in the same group. Clients and members have requested greater harmonisation of procedure and practice across CCPs in the same group and this can be better achieved by having employees who service multiple CCPs. Last but not least we envisage that there could be considerable benefit in particular for business continuity arrangements in cross-training/rotating employees between CCPs in order to ensure that both human and system resources are available for disaster recovery.

We propose that in paragraph 5 the words 'its own' are replaced by "sufficient": "*[...] a CCP shall have **sufficient** dedicated human resources which are not shared with other group entities'*".

Board independence

The text may also imply that there is a problem having members sit on both group and entity-level Boards. "A CCP that is part of a group shall take into account any implications of the group for its own governance arrangements including whether it has the necessary level of independence to meet its regulatory obligations as a distinct legal entity and whether its independence could be compromised by the group structure or by board members also being members of the board of other parts of the same group".

It seems to us that EMIR drafting does not take into account a group structure containing more than one CCP and that EMIR is using the term 'group' to mean a group of companies which includes one CCP and also non-CCP entities. One could see conflicts arising in such a context, but that is not at all likely with regard to a CCP-only group.

If, however, EMIR's drafting is intended to apply to such a group structure then it is not clear to us whether the language is intended to address conflicts of interest of directors (as individuals) that are members of the Board of different entities (for which we believe a robust conflicts procedure in place can be set out in both the conflicts of interest policy and the articles of association of the CCP) or whether it is intended to have a much wider remit than that and capture the inter-relationship between group entities and cross-directorships on their respective Boards. Clearly, to have separately composed Boards is highly inconvenient and CCPs would lose the coherence of a coordinated approach to clearing a range of products across a range of markets.

We would suggest deleting the last portion of the first sentence of para 5: “*and whether its independence could be compromised by the group structure or by board members also being members of the board of other parts of the same group”.*

Reporting lines (Article 2 ORG rule 5, Article 3 ORG rule 6, Article 8 ORG rule 2)

For Risk, the "risk management function" must have a "direct reporting line to the board" – Article 2(5) ORG

For Compliance, a "chief compliance officer" should "report directly to the board" – Article 3(6) ORG

For Internal Audit, the "internal audit function shall report directly to the board" – Article 8(2) ORG

2.5. A CCP shall establish a risk management function. The CCP shall ensure that the risk management function has the necessary authority, resources, expertise and access to all relevant information, is sufficiently independent from the management and has a direct reporting line to the board. The CCP shall appoint a chief risk officer who shall implement the risk management framework including the policies and procedures established by the board.

3.6. The CCP shall designate a chief compliance officer who is responsible for the compliance function and who shall be sufficiently independent from senior management, report directly to the board.

8.2. The internal audit function shall have the necessary authority, resources, expertise, and access to all relevant documents. It shall be sufficiently independent from the management and shall report directly to the board.

We support the principle of an independent Risk Committee and Audit Committee and the notion of full, unencumbered access by the independent Chairman of the Risk Committee to all and any risk related matters, information and personnel. However, the current drafting gives the impression that, for example, the Risk Management function is to be put into a literal, hierarchical relationship of being subordinate to the Board (member(s)) who will directly determine and control each Risk Officer's pay, workload etc. A reporting line directly to the Board would also dilute accountability and diminish the answerability of the CEO who should have direct responsibility, accountability and authority on the various key functions. Once again we do not see why CCPs should be the only financial institutions to be subject to such a requirement. We do not believe it is the intention of EMIR to do that. We think it more likely that the relationship intended here is "report to" in the sense of "make information available to’.

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Our suggested clarification is to *have the "reporting line" language amended to "making information available to" the Board* rather than the Board having a more involved, supervisory role. If the Board has a more involved role this could potentially conflict with the concept of independence from the company and is unlikely to be the true intention of EMIR.

Compliance (Article 3 ORG rule 1)

1. A CCP shall establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the CCP and its employees to comply with the CCP's obligations under this Regulation, the Regulation (EU) No xx/xxxx [EMIR] and Regulation (EU) No xx/xxxx [Commission Implementing Regulation], as well as the associated risks, and put in place adequate measures and procedures designed to minimise such risk and to enable the competent authorities to exercise their powers effectively under these Regulations.

We welcome the fact that ESMA requires a robust Compliance function but also recognises the practical limits to its powers to ensure total compliance at all times. The references to having policies and procedures that are "designed" to detect failure and to "minimise" such risk reflect a pragmatic view.

Remuneration Committee (Article 4 ORG rule 1)

1. A CCP shall define the composition, role and responsibilities of the board and senior management and any board committees. These arrangements shall be clearly specified and well-documented. The board shall establish, at a minimum an audit committee and a remuneration committee. The risk committee established in accordance with Article 26 of the Regulation (EU) No xx/xxxx [EMIR] shall be an advisory committee to the board.

A strict reading of para 1 of Article 4 would require each CCP within a group to have its own Audit and Remuneration Committees. It seems clear that whilst ESMA is aware of the LCH.Clearnet group's multi-CCP structure, it appears that this has not been taken into account in the drafting of EMIR. It would seem unnecessarily inefficient to have to constitute a Remuneration and Audit Committee for each CCP, which could well have the same personnel and near-identical Terms of Reference, and we would invite ESMA to consider the circumstances of multi-CCP groups more generally. Finally, we do not believe that CCPs should be the only financial industry participants required to have an Audit and Remuneration Committees for each entity within a group.

We suggest that the following is added at the end of the second sentence "*The audit and remuneration committees may be shared by a Group where the relevant competent authorities are satisfied that there are arrangements in place to mitigate any conflicts of interest."*

Remuneration policy (Article 5 ORG)

4. The remuneration policy shall provide that staff engaged in risk management, compliance and internal audit functions are remunerated in a manner that is independent of the business performance of the CCP. The level of remuneration shall be adequate in terms of responsibility as well as in comparison to the level of remuneration in the business areas.

We have concerns with the proposal that staff engaged in risk management, compliance and internal audit functions are remunerated in a manner that is independent of the business performance of the CCP. The business performance of a CCP is dependent on effective risk management and compliance. A failure by one of these functions would have a very large impact on the performance of the CCP. It is therefore essential that a CCP is able to attract highly qualified risk and compliance staff and reward them in line with their performance. It seems odd to define that the form of remuneration of a type of function should be determined on a different basis than for another. This limitation does not apply to banks, fund managers, insurers, etc.

Chapter VII – Margins – EMIR Article 41

A general comment that applies here is that the rules appear over-prescriptive given the range of instruments with differing characteristics that CCPs clear. The proposals are only appropriate in the context of the simpler margining algorithms in place for example for exchange-traded derivatives and are not applicable to the advanced models used for OTC markets. We are concerned that the level of prescription envisaged by ESMA could stifle innovation in risk management and therefore be counter-productive.

Percentage (Article 1 MAR)

1. A CCP shall calculate the initial margins to cover the exposures movements for each financial instrument that it is margined on a product basis, over the time period defined in Article 2 MAR and assuming a time horizon for the liquidation of the position as defined in Article 3 MAR. For the calculation of initial margins the CCP shall at least respect the following confidence intervals: a. for OTC derivatives, 99.5%. b. for financial instruments other than OTC derivatives, 99%

We support the general approach towards differentiating between OTC derivatives and other instruments; however we have a concern over the definition of OTC. This refers under EMIR to derivatives that are not transacted on a Regulated Market. It would therefore apply, for example, to any derivatives traded on an MTF. If the degree of standardisation and liquidity of a derivative traded on an MTF were such as to warrant a shorter holding period, this should be permitted. In general we do not believe it is always appropriate to determine risk management practices with reference simply to the regulatory status of a trading venue.

A related point is that CCPs should be able to portfolio-margin similar products traded on different venues, and this would be hampered by any requirement to adopt differing holding periods.

We recommend that the differentiation is expressed as "*for derivatives transacted OTC*' and '*for instruments transacted other than OTC*".

Time horizon for the calculation of historical volatility (Article 2 MAR)

1. A CCP shall assure that according to its model methodology and its validation process established in accordance with Chapter XIII, initial margins cover at least with the confidence interval defined in article 1 an historical volatility calculated weighting equally the two following periods: a. The latest 6 months b. The 6 months reflecting the most stressed market conditions during the last 30 years or as long as reliable price data is available. 2. A CCP may use any other time horizon for the calculation of historical volatility periods provided that the use of such time periods results in margin requirements at least as conservative as those obtained with the time periods defined in the paragraph 1. 3. A CCP shall define and use other time horizons for the calculation of historical volatility when, according to the revision of the margin models outlined in Chapter XIII, the periods referred to in paragraph 1 do not properly contain the necessary information to assure that the margins ensure the protection of the CCP with the required degree of coverage. The CCP shall assure that the new time horizons produce conservative margin requirements. 4. Margin parameters for financial instruments without a historical observation period shall be based on conservative assumptions. The CCP shall promptly adapt the calculation of the margins required based on the analysis of the price history of the new financial instruments.

We have a number of concerns with the over-prescriptive proposal for the lookback periods. As we understand it, the concern is that a short lookback period would be too pro-cyclical and fail to take account of past market stresses, and that too long a period would give too much weight to events long in the past potentially with little relevance to current market events.

As stated in the CPSS-IOSCO Principles for Financial Market Infrastructures, "Selection of the period should be carefully examined based on the theoretical properties of the margin model and empirical tests on these properties using historical data. In certain instances, a CCP may need to determine margin levels using a shorter historical period to reflect new or current volatility in the market more effectively. Conversely, a CCP may need to determine margin levels based on a longer historical period in order to reflect past volatility."

In particular, we have the following concerns with the proposed methodology:

- Applying an equal weighting may overstate the risk when the stressed period occur in different market conditions, for example applying stressed scenarios from high yield inflationary environments (1980s/90s) in a low yield environment (2000s). CCPs spend considerable time and effort to adjust for such effects where appropriate.

- It is not clear how the two periods would cope with seasonality effects in the commodity markets. It would not seem appropriate to apply high seasonal effects in low season environments. Ignoring seasonal effects altogether gives the impression the CCP does not comprehend the dynamics of seasonal demand and supply.

- Prescribing two fixed periods of 6 months would also be at odds with those CCPs who apply risk factor models from return distributions covering several years of data in order to determine an estimated distribution of future exposure.

- Calculating volatility over two independent periods would also break correlation properties relied upon in margin models using historical distributions. A margin model may be relying on correlations over the last 2 years, while the volatility is based on some other period(s). The correlation co-efficient of two financial variables over time (t) is the covariance of those variables divided by the products of standard deviations over the same time (t). If different time periods are used to determine the standard deviation from the covariance then the correlation estimates will be incorrect.

- Historical stress (and hypothetical stress) events over the last 30 years are already captured in the daily default fund stress testing.

- "The 6 months reflecting the most stressed market conditions in the last 30 years", if taken to mean for a given portfolio the single six month period which if chosen would yield the most conservative initial margin, would be different for different asset classes and portfolios, and indeed different for even slightly different margin models. Even the selection of such a six month period for a given portfolio is non-trivial and involves a large number of calculations. The "worst" six month period is very likely to strictly dominate the effect of the most recent six month period, providing a margin methodology this is relatively insensitive to current market conditions

- Markets have changed beyond recognition in the last 30 years and specific events of the past such as the European Rate Mechanism may no longer be relevant.

In short, we believe that CCPs should be able to select their own lookback periods for the various instruments that they clear. Therefore we recommend that this Article is amended as follows:

"1. A CCP shall assure that according to its model methodology and its validation process established in accordance with Chapter XIII, initial margins ~~cover at least with the confidence interval defined in article 1 an historical volatility calculated weighting equally the two following periods:~~

~~a. The latest 6 months~~

~~b. The 6 months reflecting the most stressed market conditions during the last 30 years or as long as reliable price data is available.~~

~~*2. A CCP may use any other time horizon for the calculation of historical volatility periods provided that the use of such time periods results in margin requirements at least as conservative as those obtained with the time periods defined in the paragraph 1.*~~

~~*3. A CCP shall define and use other time horizons for the calculation of historical volatility when, according to the revision of the margin models outlined in Chapter XIII, the periods referred to in paragraph 1 do not properly contain the necessary information to assure that the margins*~~ *ensure the protection of the CCP with the required degree of coverage. The CCP shall assure that the new time horizons produce conservative margin requirements.*

~~4~~. Margin parameters for financial instruments without a historical observation period shall be based on conservative assumptions. The CCP shall promptly adapt the calculation of the margins required based on the analysis of the price history of the new financial instruments".

Time horizons for the liquidation period (Article 3 MAR)

4. A CCP shall use the same time horizons for the liquidation period for the calculation of the margin requirements for all the types of accounts a CCP may keep open according the Article 39 of EMIR.

Paragraph 4 indicates that a CCP "shall use the same time horizons for the liquidation period for the calculation of the margin requirement for all types of account a CCP may keep open ...". The RTS should recognise that it may take longer to port client positions than to close a clearing member's proprietary position and allow CCPs to use a longer liquidation period for clients. We would expect this more conservative approach to be allowed by the RTS and *ask that this requirement (paragraph 4) be removed.*

Portfolio margining (Article 4 MAR)

1. A CCP may allow offsets or reductions in the required margin across the financial instruments that it clears if the price risk of one financial instrument or a set of financial instruments is significantly and reliably negatively correlated with the price risk of other financial instruments. 2. The CCP shall document its approach on portfolio margining, in particular it shall at least provide that: a. The correlation between two or more financial instruments cleared is evidenced over two years and, demonstrates resilience during stressed historical or hypothetical scenarios. The CCP shall demonstrate the existence of an economic rationale for the price relation. b. The level of negative price correlation should be at least minus 70% for each pair of financial instruments or for each pair of baskets of financial instruments where the offsets are allowed. Temporary fluctuations in the level of correlation may be acceptable provided that the negative price correlation remains below minus 50% and that the fluctuation is for a period no longer than 3 months. 3. All financial instruments to which portfolio margining is applied shall be covered by the same default fund. 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. 5. A CCP may use any other procedure for the calculation of the adequate offset between different sets of products periods provided that the margin requirements are at least as conservative as those defined in this Article, it is able to demonstrate a clear convergence with the parameters specified in paragraph 2 and the

approach used is based on a sound theoretical framework and subject to ongoing review.

6. The margins offsets related to portfolio margining shall be subject to a sound and meaningful stress test programme in accordance with Chapter XIII.

We have a number of comments in relation to portfolio margining. Overall, CCPs must be able to define an appropriate margin methodology to capture the actual margin offsets consistent with a robust default management process. We do however support provisions that would prevent the irresponsible implementation of portfolio margin reductions based on temporarily-observed correlation or diversification effects applying across widely differing asset classes.

In particular, there should be an explicit statement that for the purposes of paragraphs 2 and 4, different series and delivery months of options, futures and other derivatives of the same underlying can be treated as different forms of the same instrument, and not as different instruments.

Correlation (para 2)

In the case where a distinct inter-commodity spread credit is offered between two pre-defined but different financial instruments the application of a minimum correlation co-efficient is prudent. A minimum correlation co-efficient of 70% seems reasonable in this context. Such cases are typical in products which are margined using SPAN or similar algorithms. However the period of measurement should be more flexible to allow for regime changes and different dynamics across markets, as in some case two years may be too long or too short. For example when two assets are de-correlating a shorter time measure may indicate correlations of less than 70%. Likewise if two assets are correlating then a shorter time horizon may indicate correlation of more than 70%. Therefore ESMA should consider a range of correlation windows to give CCPs more flexibility such as one, two, or three years.

In the case where a distinct spread charge is applied to two pre-defined identical financial instruments but with different maturities the application of a minimum correlation is prudent. In this case it is the dynamics of the term structure that will affect the level of offset. Such cases are also typical in products margined under SPAN-type algorithms. As above, more flexibility is needed for CCPs to determine the appropriate correlation window such as one, two, or three years.

In the case where there is a portfolio of related instruments which are identical or similar in nature and margins are derived from the simulated *portfolio* returns there is no distinct spread credit or spread charge to interrogate. The portfolio margin is based on all the returns of all the instruments simulated together over time. The simulations can be derived from risk factor returns such as interest rate returns, foreign exchange returns and underlying asset price returns. There will likely be an inordinate amount of possible correlation coefficients, but none of which would have a distinct spread credit associated in the margin. Therefore it is impossible to apply this paragraph to this type of portfolio margin as no particular pair of instruments has a distinct offset. It is the returns of the portfolio as a whole, which determine the margin. The portfolio returns being derived from the underlying risk factor returns. For multicurrency portfolios and interest rate portfolios correlation coefficients between different interest rates and foreign exchanges may be below 70%, for example 3 month interest rates and 30 year interest rates. However, this does not mean a significant offset will be applied as it is the historical (or simulated) distribution that will determine the worst profit and loss. As long as the CCP demonstrates that the instruments eligible for the portfolio margin are based on a sound theoretical framework and subject to on-going review such portfolios should be exempt from Para 28, such portfolios being those where margins are derived from simulated portfolio returns often applied in various derivations of value at risk models used by CCPs.

We therefore suggest that *the correlation constraint is removed and replaced with language similar to the US CFTC regulation which states correlations between related positions should be significantly and reliably correlated.*

Instruments in separate default funds (para 3)

In relation to instruments which are covered by separate default funds, portfolio margining can still be appropriate provided that the CCP has more than adequate financial resources to cover replacement costs. The adequate resources will be determined by separate default fund stress tests for each financial instrument within the portfolio but belonging to a different default fund. Therefore the stress risk loss is similar to a gross stress loss rather than a portfolio net stress loss. One simple example is bond futures against cash T-Bonds. The cash position is in one DF, the bond future in another DF. Each position is subject to a stress loss with respect to their corresponding DF stress scenarios. However the Initial Margin can be calculated as a net position cash & futures (basis trade) using a portfolio margin calculation. In a default, the position would be liquidated as a portfolio position and profits and losses allocated to each default fund.

As opposed to auctioning positions by financial instrument, the CCP would auction the defaulter's positions across instrument types as a single portfolio e.g. Repo, Listed and Swaps products and allocate the profits/losses pro-rata back to the related default fund. This would reduce the risk involved during default by simplifying the unwinding of positions during the auction process, reducing risk exposure as now related positions are not sold piecemeal potentially increasing market risk. Auctioning positions within a product area is a complex task in itself e.g. Futures & Options. However, the complexity of the challenge is further compounded if positions are now unwound for different instruments separately, hence the proposal to auction the portfolio as a whole.

Chapter X – Default Waterfall – EMIR Article 45

Calculation of the amount of the CCP's own resources to be use in the default waterfall (Article 1 DW)

1. A CCP shall keep, and indicate separately in its balance sheet, an amount of dedicated own resources for the purpose set out in Article 45(4) of Regulation (EU) No xx/xxxx [EMIR]. This amount shall be at least equal to the

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50 per cent of the capital, including retained earnings and reserves, held in accordance with Article 16(2) of Regulation (EU) No xx/xxxx [EMIR]. The CCP shall revise this amount on a yearly basis. 2. Where the CCP has established more than one default fund for the different classes of financial instruments it clears, the total dedicated own resources calculated under paragraph 1 shall be allocated to each of the default funds in proportion to the size of each default fund, to be separately used for defaults arising in the different market segments to which the default funds refer to. 3. No resources other than capital, including retained earnings and reserves, as referred to in Article 16(2) of Regulation (EU) No xx/xxxx [EMIR] can be used to comply with the requirement under paragraph 1.

ESMA proposes a requirement that a CCP should use dedicated own resources (‘DOR’) to an amount equal to 50% of its capital requirement to cover a member default after using the defaulting member’s own resources but before using the resources of non-defaulting members.

We welcome the fact that the rules envisage that the total DOR would not have to be held for each business lines but that instead DOR shall be allocated to each of the default funds in proportion to the size of each default fund.

We are aware that this is a requirement of the Level 1 Regulation but note that an open horizontal CCP where the management does not have any shareholding in the firm, the argument is actually at the cost of very same users/members the requirement is to protect against the default of another clearing member. In fact if a series of defaults leads to use of Default Fund, the surviving members (shareholders of the LCH Clearnet) would actually be impacted further by the risk participation. In addition, we note that Dodd-Frank has no such requirement and this also runs contrary to creating a level international playing field.

We recommend that ESMA recalibrate the level of skin in the game to 10% of risk capital alone instead of 50% of minimum capital required for the following reasons:

- Linking DOR to wind-down capital seems illogical as the intention of DOR is to incentivise the CCP’s management not to take undue risk;

- The purpose of the DOR is to incentivise a CCP’s management to manage risk prudently. There is no clear rationale for the excessive amount of 50% other than to say the charge should be ‘substantial’ to be effective. For a CCP to potentially lose a significant part of its capital base on a member default would challenge its viability, create substantial undesirable systemic risk, and require recapitalisation at a time its shareholders, which may be substantially its members, may be able to least afford it;

- Having such an amount would reduce incentives on members to participate in a default management auction as they know that a significant part of the impact would be on the CCP;

- A 10% level would be sufficient to incentivise a CCP’s owners to ensure prudent risk management and there are better ways to prevent a race to the bottom amongst

CCPs which the DOR seeks to achieve, i.e. through governance and remuneration policies. These are already adequately covered by the proposed Standards and in our view there is limited additional security to be gained by having any greater amount of dedicated financial resources.

We have set out in some greater detail the potential impact on LCH Clearnet of the proposed DOR requirement in a separate annex that we have submitted on a confidential basis.

We understand that the intention of ESMA is that the 50% would be based on the CCP's capital requirement and would not include any additional capital that the CCP chose to hold (e.g. supervisory or internal buffers). Otherwise it would have the perverse effect of penalising CCPs that are more strongly capitalised. If our suggestion below to link DOR only to risk capital (i.e. excluding wind down costs) is not taken on board, the RTS should at least clarify that it is linked to the "minimum capital requirement".

Identifying extreme but plausible market conditions (Article 2 DF)

1. The framework described in Article 1 DF shall reflect the risk profile of the CCP. It shall identify all the markets risks to which a CCP would be exposed following the default of one or more clearing member, including but not limited to unfavourable movements in the market prices of cleared instruments, reduced market liquidity for these instruments, and declines in the market value of collateral. The framework shall also reflect additional risks to the CCP arising from the simultaneous failure of entities in the group of the defaulting clearing member.
2. The framework shall individually identify all the markets to which a CCP is exposed in a clearing member default scenario. For each identified market the CCP shall specify extreme but plausible conditions based, at least on:
a. a range of historical scenarios, including periods of extreme market movements observed over the past 30 years (or as long as reliable data have been available) that would have exposed the CCP to greatest financial risk. If a CCP decides that recurrence of a historical instance of large price movements is not plausible, it shall justify its omission from the framework to the competent authority.
b. a range of potential future scenarios, founded on consistent assumptions regarding market volatility and price correlation across markets and drawing on both quantitative and qualitative assessments of potential market conditions.

We welcome that the requirement to model all extreme events during the last 30 years only applies where the scenario is deemed still plausible, and also only where reliable data is available. However, we are concerned that a quarterly review of scenarios might become largely a box-ticking exercise. Spending more resources on less frequent reviews providing in-depth analysis of each scenario would be of greater benefit. We therefore believe that he Risk Committee should review the scenarios annually. In practice, scenarios will be reviewed constantly by the Risk teams and any new extreme events built into the modelling as soon as practicable. Results of scenario testing, in terms of calculating members' exposures and default fund adequacy should be reviewed at least daily, and presented to the Risk Committee quarterly, but to require a formal review of all scenarios quarterly would be an unnecessary overhead.

Chapter XI – Collateral – EMIR Article 46

Assets eligible as highly liquid collateral (Article 1 COL)

185. ESMA has revised the framework for managing liquidity risk along the following lines: ... b. Both money market funds and time deposits are not considered liquid financial resources. ...

We support ESMA's overall approach towards determining what assets are eligible as high quality collateral. However we encourage ESMA to work with its international counterparts to ensure a level playing field in this as for all aspects of a CCP's risk management.

We note from para. 185 on pp. 34-35 that money market funds are not considered liquid resources. However our reading of Article 1 COL is that money market funds are in principle acceptable as collateral. We believe the policy should be harmonised.

In addition, we request clarity that the reference to 'bank guarantees' (which typically need a trigger event in order to be realised) includes other documentary credits i.e. performance bonds (which are realisable on demand) and letters of credit.

Concentration limits (Article 4 COL)

1. A CCP shall establish and implement policies and procedures to ensure that the collateral remains sufficiently diversified to allow its liquidation within the defined holding period without a significant market impact. The CCP shall assess in particular the concentration of collateral provided in the financial instruments of an individual issuer, type of issuer in terms of economic sector, activity and geographic region, and type of asset or commercial bank guarantees. In order to avoid a high credit exposure to an individual issuer, type of issuer or type of asset, a CCP shall determine concentration limits at the level of each clearing member and at the level of all clearing members. The policies and the procedures shall determine the risk mitigation measures when the concentration limits are exceed by a clearing member or all clearing members in total.

We are concerned that setting concentration limits at the level of each clearing member will lead to significantly increased operational risk as members may have to diversify the form of collateral they use and may encourage the use of lesser-quality forms of collateral. We ask that ESMA recognises that there may be instances where it is not appropriate to determine concentration limits at the level of each clearing member by adding "*where appropriate*".

Chapter XII – Investment Policy – EMIR Article 47

Highly liquid financial instruments (Article 1 INV)

3. For the purpose of Article 47(1) of Regulation (EU) No xx/xxxx [EMIR], derivative contracts can also be considered highly liquid financial investments, bearing minimal credit and market risk if they are entered into for the purpose of macro-hedging the portfolio of a defaulted clearing member as part of the CCP's default management procedure and thereby reduce the credit and market risk to which the CCP is exposed, and provided that reliable price data are published on a regular basis. Where derivative contracts are used in such circumstances then such use shall be approved by the board after having consulted the risk committee.

The proposal limits CCPs' use of derivatives to default management. However, use of derivatives is a vital part of a CCPs' risk management toolbox, particularly in those areas highlighted below. Accordingly the rules should allow the prudent use of foreign exchange and interest rate derivatives to manage investment risks.

FX risk management

- CCP cash margins are often received in several currencies, but there may be a shortage of high grade collateral in the associated currency. Accordingly, there may be a necessity to use FX to transform currencies received into other currencies where there is a deeper pool of liquid high grade collateral. Appropriate haircuts should be utilised to further immunise against potential FX movements. For example, LCH. Clearnet Ltd's revenues are in a range of currencies; its functional currency is euro while the majority of its costs are in pounds sterling.

- FX hedging is a risk reducing activity. If a CCP does not hedge it is exposed to much greater FX risk.

Interest rate risk management

- In addition there is a need to hedge interest rate risk because members are remunerated on a floating rate basis and the returns on term assets held, for example a six month Government bond, are at a fixed rate. It would not be prudent practice for a CCP to remain exposed to this risk. To manage this interest rate risk a CCP should therefore be able use a derivative in the form of an Interest Rate Swap.

We note that Paragraph 3 that use of derivatives in macro-hedging a defaulter's portfolio can be deemed as compliant with Article 47(1) of EMIR. We believe that prudent use of FX and interest rate derivatives for hedging of investment risks should also be compliant with this Article subject to the same conditions of reliable price data and Board and Risk Committee approval. We suggest that ESMA amend paragraph 3 to include *"FX and interest rate derivative contracts can also be considered highly liquid financial investments where they are used to manage investment risk".* We would also welcome the clarification that CCPs are allowed to use reverse repos.

Highly secured arrangements maintaining cash (Article 3 INV)

> 2. Where cash is maintained in accordance with paragraph 1 then not less than 98 per cent of such cash shall be deposited through arrangements that ensure the collateralisation of the cash with highly liquid financial instruments meeting the requirements under Article 1 INV.

While we support the principle of collateralising the great majority of cash deposits we believe the 98% limit is too inflexible. CCPs may encounter difficulties in collateralising funds received from intra-day margin calls. We propose a level of 95% on average over a month. In addition it should not prevent a CCP's ability to deposit temporarily at settlement banks following a failure of a clearing member to deliver securities.

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While respecting the independence of Central Banks, we observe that it would be helpful, particularly in times of stress, if CCPs were able to deposit funds, including late day funds, into a central bank account. This would not imply any right to liquidity funding, but provide purely operational protection in the interest of the entire system

Chapter XIII – Review of Models, Stress Testing and Back Testing – EMIR Article 49

Model Validation (Article 1 SBT)

> 1. A CCP shall conduct a comprehensive validation of its models, their methodologies and the liquidity risk management framework used to quantify, aggregate, and manage its risks. Any material revisions or adjustments to its models, their methodologies and the liquidity risk
> management framework shall be subject to appropriate governance and validated by a qualified and independent party prior to application

We agree that material revisions or adjustments to models should only be made after independent validation. We would expect "material" in this context to only include cases where models are substantially changed or overhauled to the extent that the model becomes a completely different model. Changes to models or parameters will also be subject to the CCP's internal model governance which may include independent annual reviews. A CCP should be able to make minor changes as part of their business-as-usual model testing without independent reviews, which should be no more than annual exercises and part of the CCP's general audit programme.

Testing programme (Article 2 SB)

> 4. A CCP shall include any client positions which expose it to uncovered losses as a result of a clearing member default when performing all tests.

Article 48 of EMIR encourages portability of clients' assets and position in the event of a clearing member default. We believe that it is very likely that in many cases portability positions can be ported within the holding period. Where arrangements are in place for the clients' position and assets to be ported, it would be unreasonable to include all the client accounts in the stress test. We believe that supervisors should have the discretion to allow CCPs not to have to stress all client accounts separately where this is sufficiently prudent. This will lead to additional costs for clients and disincentivise clearing members from providing client clearing services.

Back testing (Article 3 SBT)

> 1. A CCP shall assess its margin coverage by back testing its models to calculate its initial margins against actual market changes. A CCP shall back test its models from each day in order to evaluate whether there are any testing exceptions to margin coverage. Coverage shall be evaluated across financial instruments, clearing members and take into account portfolio effects and, where appropriate, interoperable CCPs.

We do not believe it is necessary to review portfolio and risk factor testing daily, this should be monthly at most. Daily testing of initial margins is however necessary.

We do not agree with the proposals relating to disclosure of back testing. This is a complex topic and should be disclosed only to the Competent Authorities and Risk Committees who are familiar with the backtesting methodologies.

Stress testing (Article 5 SBT)

7. Stress testing results and analysis shall be made available to all clearing members and, where known to the CCP, clients. For all other clients back testing results and analysis shall be made available by the relevant clearing members on request. Such information shall be aggregated and clearing members and clients shall only have access to detailed stress testing results and analysis for their own portfolios.

Similarly, disclosing stress and backtesting results to members may lead to undue pressure to amend scenarios or enable gaming. Stress scenarios and test results should be disclosed to Risk Committees and Competent Authorities only.

Frequency of testing (Article 13 SBT)

7. A CCP shall conduct a detailed thorough analysis of testing results at least on a monthly basis in order to ensure its stress testing scenarios, models and liquidity risk management framework, underlying parameters and assumptions are correct. Such analysis shall be conducted more frequently in stressed market conditions, including when the financial instruments cleared or markets served in general display high volatility, become less liquid, or when the size or concentrations of positions held by its clearing members increase significantly or when it is anticipated that a CCP will encounter stressed market conditions. 12. A CCP shall test and review its default procedures in accordance with Article 12(1) SBT at least quarterly and perform simulation exercises in accordance with Article 12(3) SBT at least annually. A CCP shall also perform simulation exercises following any material change to its default procedures and following the addition of any new types of contracts being cleared by the CCP.

We believe that the “detailed thorough analysis” of testing results only need to be performed by a CCP quarterly, or more frequently in stressed conditions. In addition, the testing of default procedures should be performed no more than twice yearly in order to reduce the burden on members that are active on multiple CCPs.

Draft implementing technical standards on record keeping requirements for CCPs

General provisions (Article 2)

2. A CCP shall establish and maintain a record-keeping system which satisfies the following conditions: a) it prevents the alteration of the records; b) it ensures the security and confidentiality of the data recorded; c) it incorporates mechanisms for identifying and correcting errors; d) it includes appropriate precautionary measures to enable the timely recovery of the records in the case of a system failure.

2 a) and c) seem contradictory, in that alteration of records must be prevented, yet mechanisms to identify and correct errors are requested. We agree with the proposal (p28, para. 150) that there should be "procedures and controls in place relating to the preservation of the records and the authorisation and logging of any alterations"; yet this does not seem to have been incorporated in the draft ITS as indicated. *We suggest replacing point a) of paragraph 2 by "it incorporates procedures and controls on the authorisation and logging of any alteration and the preservation of the records".*

Formats of records (Article 3)

Article 3 and the associated annexes prescribe the formats in which records of contracts, positions and business activities must be kept. Providing a CCP retains at least the equivalent data points and can produce reports or files in a suitable format, it seems unnecessarily costly and laborious to require existing databases and storage solutions to be re-engineered to match the prescribed formats.

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Draft Regulatory Technical Standards on the minimum details of the data to be reported to Trade Repositories – EMIR Article 9

Consultation paper

269. ESMA believes that in order to effectively match counterparties to a trade, where those trades are reported separately by each counterparty (potentially to two different trade repositories), a Unique Trade Identifier (UTI) or other trade ID should be reported with each counterparty to allow for the matching of each side of the transaction.

292. Whilst no specific question was raised in the DP, EMSA considers that there is a need for the details of a contract to be reconciled or agreed between two counterparties when reporting to different counterparties. Reconciliation would be expected to reduce the number of un-matched trades across TRs. Also, EMIR states that data needs to be aggregated and compared across TRs so that a number of authorities can access this data. Two possible solutions have been considered in the cost benefit analysis; to require the counterparties to reconcile the data or to require TRs to reconcile the data of a trade report when the counterparties are reporting to different TRs. 293. ESMA feels it would be impractical and potentially costly for each counterparty to communicate and confirm the details of every transaction with the other counterparty before it is reported to the TR. It would therefore be more practical for TRs to perform this role after the data is reported to the TRs. Furthermore, some TRs are already in a position to offer matching services to their clients. However, ESMA recognises that this option would still be costly and complex for TRs and there would be a need for a UTI or other common trade ID to allow TRs to compare data without breaching confidentiality. The draft RTS requires that where counterparties are reporting to different TRs, TRs should use, where available, universal codes to ensure that the common data is reconciled between counterparties.

With reference to p47, para 269 and p50, paras 292/3, issues arising from duplication of data where trades are reported separately, 'potentially to two different trade repositories' are proposed to be resolved by Trade Repositories 'reconciling the trade report. This would be a very complex and costly system for TRs to manage, and poses an unprecedented strain on data security and confidentiality rules.

The CFTC has proposed a system whereby there is a single reporting counterparty for each trade, dictated by a market hierarchy or agreement as a term of the trade. In the interests of striving towards the standardisation intended by the G20 Trade Repository commitments, and to limit the development, cost and operational burden on market participants, we request that ESMA consider a convergent approach to reporting protocol. Under the current proposals, a CCP may need to report lifecycle data for a single trade to 3 Repositories – 2 European TRs and a US Swap Data Repository – should two European counterparties execute on a US-regulated Swap Execution Facilities or Designated Contract Market, which would fragment and duplicate information relating to the 'golden record' residing at the CCP itself.

We recommend that ESMA explores the possibility of requiring counterparties to agree between themselves on who will report. The production of only one report per transaction would alleviate the need for costly reconciliation and be more consistent with the US.

295. Whilst ESMA understands the need to begin reporting as soon as practicable and in line with the G20 commitment, setting the start date after the authorisation of a TR would allow the industry (both TRs and

counterparties) to have sufficient time for implementation, while still ensuring that there will be at least a TR available and authorised to receive transaction reports for that asset class. It would also avoid direct reporting to ESMA, who will not have the necessary operational and IT structures in place to appropriately deal with receiving potentially large numbers of complex trade reports that no TR would be dealing with. On the other hand, setting a fixed date after the adoption of EMIR and the technical standards would give market participants as well as TRs and authorities the legal certainty that reporting is going to start in a specified point in time.

We welcome the proposal in p51, para. 295 to allow “sufficient time for implementation” for market participants to connect with authorised Trade Repositories.

Details to be reported (Article 3)

LCH.Clearnet recognises the value of reporting transaction data for over-the-counter derivatives asset class and it agrees that it would lead to greater transparency for the market and reduce systemic risk as a whole. However, LCH.Clearnet believes that exchange traded and exchange traded look-alike derivatives (“ETDs”) should be treated differently due to the higher transparency of the exchange traded derivatives market and the lower systemic risk that exchange traded products represent.

The reporting of transaction data for exchange traded derivatives would create significant costs to market participants due to the huge volume of trades that are being transacted on a daily basis.

A significant number of positions are opened and closed intraday, thus we believe that only end of day aggregated client position data for ETDs should be reported. Given that transactions that do not result in open positions do not add to systemic risk, reporting the aforementioned transactions would only add to the cost and complexity of reporting and create additional burden for the regulators to manage the relevant data.

ETDs are standardised contracts traded anonymously on exchanges. The repetition of standardised data for significant volumes would not add any value to ESMA’s declared objectives. While we recognise the relevance of the fields presented at table 1 of Annex 1 (p.142) of the ESMA consultation paper to certain OTC derivatives, due to the aforementioned reasons, the fields are not applicable to ETDs. The reporting of end of day client position data, however, would provide an accurate depiction of the market and the risk held by market participants.

We recommend that only end of day aggregated position data for ETDs should be reported.

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Draft Regulatory Technical Standards specifying the data to be published and made available by trade repositories and operational standards for aggregating, comparing and accessing the data – EMIR Article 81

Operational standards for aggregation and comparison of data across trade repositories (Article 5)

1. A trade repository shall provide access to the entities listed in Article 81(3) of Regulation (EU) No xx/2012 [EMIR] in accordance with the relevant international communication procedures and standards for messaging and reference data. 2. ESMA may issue guidelines or recommendations identifying relevant international Communications procedures and standards for messaging and reference data for the purposes of this Article under the procedure described in Article 16 of Regulation 1095/2010 of the European Parliament and of the Council.

Article 5 is entitled "operational standards for aggregation and comparison of data across trade repositories", yet does not explore possible operational solutions to reconciliation of duplicated data across multiple repositories. This is a critical issue in the proposed reporting mechanism and may result in unnecessary development, cost and complexity for reporting parties – particularly CCPs – in the provision of continuation/lifecycle data. As noted above we would recommend that only one report is produced per transaction. This would reduce the need for reconciliation of reports.

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Draft Implementing Technical Standards with regard to the format and frequency of trade reports to trade repositories – EMIR Article 81

Recital 2

2) To ensure consistency, all parties to a trade should be identified by a unique code. A global legal entity identifier or an interim entity identifier, to be defined under a governance framework which is compatible with the FSB recommendations, should be used to identify all financial and nonfinancial counterparties, brokers, central counterparties, and beneficiaries once available, in particular to ensure consistency with the CPSS-IOSCO report on OTC Derivatives Data Reporting and Aggregation Requirements that describes legal entity identifiers as a tool for data aggregation. In the case of agency trades, the beneficiaries should be identified as the individual or entity on whose behalf the trade was concluded.

The CFTC has recently elected DTCC-SWIFT as provider of interim LEIs; we request that ESMA follow the same standard, in order to minimise development complications and cost in already divergent global reporting requirements.

Subject matter (Article 1)

This Regulation lays down implementing technical standards specifying the following: (a) the format and frequency of the reports on derivative contracts made in accordance with Article 9 of Regulation (EU) No xx/2012 [EMIR]; (b) the date by which such derivative contracts shall be reported;

Article 1 (a) states that the technical standards will specify the 'the format and frequency of the reports', yet no specification of reporting frequency is given. We believe the intention is that reporting should take place on the day of execution. We urge ESMA to clarify that reporting should take place on the day of execution and provide guidance on continuation/lifecycle data to be reported.

Reporting of collateral (Article 5)

1. Where collateral is reported as exchanged on a portfolio basis, the following information shall be reported for all the collateral exchanged: a. collateral type; b. collateral amount; c. currency of collateral amount. 2. Where collateral is reported on a portfolio basis, the specific contracts over which collateral has been exchanged.

Article 5 states that with each trade report, details of collateral composition and value must be reported. Whilst this allows for the specification of portfolio-level collateralisation, the extent of mixed collateral is not accounted for. Across a large portfolio, or group of portfolios, multiple currencies in cash and multiple bonds may be provided as collateral cover. Under segregation and portability requirements, the single-currency fungible cash value of such collateral will be recorded on ledger accounts – as will be available in the event of liquidation under Rights of Use in a default scenario – which we suggest would be a more accurate and quantifiable way to segregate and report collateralisation against individual trading entities.

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We therefore recommend replacing 'collateral amount' by 'the single-currency fungible cash value of such collateral'.

We feel that Annex 1 to ITS for Article 9, being format and data tables for counterparty and common trade data, requires further clarification, specifically in Table 2 (common data):

> *39 (Fixed rate day count fraction):* The prescribed format seems incompatible with market standard expression (i.e. 'Actual/365', '30B/360', etc). We urge that market standards are respected.
>
> *43 (Floating rate to floating rate)/44 (Fixed rate to fixed rate)/45 (Fixed rate to floating rate):* We would anticipate these fields to be expressed as 'Y/N', with only one being 'Y', indicating the leg type, rather than numerical digits
>
> *48 (Exchange rate 2):* We do not understand what this field refers to.
>
> *51 (Exchange rate basis):* We do not understand what this field refers to.

As a general, yet important comment regarding the reporting of data to TRs is that the focus of the requirements remains on transaction data; however, for much of the derivatives business cleared by CCPs, it is not the original 'trade' that is retained, but rather the rolling position as affected by each trade. Trades are rolled up into positions on a daily basis, with positions revalued each night using the previous day's closing price. This is therefore technically a new transaction against the member for the entire position, which could be made up of many trades (and may consequently have been reported to multiple TRs). We believe that the intention of the regulator is that this also should count as a 'transaction' which needs to be passed to a TR.

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We urge ESMA to consider these arguments carefully. No CCP is more concerned about the safety of the world's financial markets than LCH.Clearnet and our history fully bears this out. The prospect of developing an efficient European financial system that remains properly competitive with third countries must not be destroyed through the introduction of disproportionate requirements, the cost of which would ultimately be borne by European enterprises and individuals.

Yours sincerely

Ian Axe

Ian Axe
Chief Executive Officer