

European Securities and Markets Authority
103, rue de Grenelle
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Paris, 15th of March 2012

**Purpose: ESMA consultation around the Discussion Paper
Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories**

Natixis Asset Management (NAM) would like to thank the European Securities and Markets Authority for the opportunity they afford to participate and answer to the consultation on the technical standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories.

Natixis Asset Management contribution is particularly focused on the questions the European Securities and Markets Authority addressed more specifically on the OTC Derivatives (part III.I) in order to reflect its views on its own business area, the Asset Management.

Please find here below the responses and contributions of our experts to the consultation.

Natixis Asset Management would also have the following general comments:

- There is no recognition of the agents/fund managers and other intermediaries acting for clients roles and responsibilities; and
- The only focus would seem to be on the position of CCPs. There should also be some reference to how long it will take counterparties to move to clearing of specific types of derivative; and
- The clearing house or CCPs foresee to impose higher haircuts/require further initial margin where a clearing member's credit rating slips below A. Client will be required to pay additional margin unless contracts can be transferred to another clearing member. What if a crisis and no clearing member used by a client has sufficient rating? What will be the effect on market for collateral? Haircuts and collateral, which are key elements, will rest on interpretation and model applied by CCP; and
- The reporting requirements should be met by trying as far as possible to use those which already exist.

Best regards

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

With respect to cross-border transactions, both Dodd-Frank and EMIR regulations intend to have some extraterritorial effects. Thus Title VII of Dodd-Frank Act (DFA) states that swaps under CFTC jurisdiction will not be subject to the DFA regulation unless they have a “direct and significant connection with activities in, or effect on, commerce in the United States”; or “contravene CFTC rules intended to prevent evasion of US requirements”. With respect to swaps under SEC jurisdiction, the DFA will not apply to the swaps entered into outside the United States, unless they contravene SEC rules intended to prevent the evasion of US requirements. But up to now, there are no objective criterions adopted by the SEC or CFTC bringing more details on the extraterritoriality rules.

Regarding EMIR, ESMA should define the concept of “substantial and foreseeable effect in the EU” using several objective criterions such as the an OTC transaction being entered into by two third country entities but acting on behalf of EU end-users, the existence of a multi-branch activity in EU of the third country entity.

By specifying such concept, third country entities will be able to check easily before entering into a swap if their swaps have or not a “substantial and foreseeable” effect in the EU.

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 in a third country?

Views of NAM's Legal Department:

In case where two third country entities would enter into a swap for the purpose of the evasion of any provision of EMIR (the “Swap”), we think that the following distinction should be made: if the Swap falls into the scope of a regulation which is similar to EMIR and provides for clearing rules, and there is a live connection/cooperation process between the two ranges of regulators, the third country entities should not necessarily be covered by EMIR. But, in case where the Swap falls out of any similar regulation (tax havens for instance), it should be covered by the EMIR Regulation.

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

In order to reduce counterparty risk, ESMA should promote some equivalence between the relation CCP/Clearing member and the relation Clearing member/Client and take into consideration different legal treatments in Europe as regards to segregation, portability and default procedure. In some European jurisdictions, segregation, portability and default procedure may not apply the same way. Furthermore, as of today, CCPs do not propose to their members the same legal documentation (ISDA Master Agreement, Tripartite agreement, Terms of Business). A comparison to the existing listed derivatives market should be made as well as a comparison with the American FCM model. Counterparty risks will mainly be borne by CCPs. Consequently ESMA should receive their comments/approval on a common legal documentation.

Q4 & Q7:

It is important that the eligibility criteria are homogenous, in particular between Europe and the U.S., in order to ensure that certain transactions are not exempt because of gaps between different regulatory regimes.

ISDA has published standard market practices which define different instruments. We suggest that ESMA refer to these market practices in defining the instruments that are required to be cleared.

Before determining whether an instrument should be cleared, ESMA should have a clear view of what is actually traded by looking at the reports of bilateral transactions. We suggest that ESMA carefully examine what is done by DTCC on the CDS market. DTCC provides sufficient granularity in the description of the transactions. ESMA should also consider the liquidity of the transactions before determining whether it is clearable.

For FX transactions, it is important to concentrate on highly-traded currencies for NDF, for example, and not try to clear all transactions.

This bottom-up approach needs to be further clarified by ESMA for its next consultation, notably around roles and responsibilities.

Regarding the specifications for assessing standardisation, volume and liquidity, availability of pricing information, we agree with the elements that ESMA will be considering.

Q8: What are your views regarding the details to be included in ESMA Register of classes of derivatives subject to the clearing obligation?

We agree with the details to be included in the Register of classes of derivatives.

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?

We 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.

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?

We do not consider the above consideration as totally appropriate. First, before setting a threshold, it should be determined whether a derivative products that can be cleared, ie there is a CCP that is able to clear the product.

In addition, we would like to highlight the fact that notional amounts could not be very practical as a measure of exposure or risk due to the fact that they do not reflect the real risk.

In fact, it is difficult to compare the notional amount of an interest rate swap where only interests are exchanged with the notional amount of a credit derivative such as a Credit default swap or an Optional product (for example Option on an index CDS).

Net notional exposures shall be considered as a measure instead of gross notional. An appropriate, thus not perfect, measure could be the delta to the underlying exposure, as measured by simple standard models.

We understand the need of simple measures, however, as we consider derivatives that could be exotic, simple measures could be misleading on the real risk of a given OTC product.

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?

The timeliness of confirmations on transactions which have not been electronically executed or processed is very slow and variable. Pre-confirmation timing varies from a couple of hours after the transaction has been dealt right up to settlement date and the final confirmation duly signed by all parties varies depending of the efficiency of the parties involved.

Using electronic platforms increases efficiency and strengthens risk management allowing transactions to be confirmed within two hours after execution and at the latest, on trade date itself.

We consider that it could be useful to clarify the meaning of 'differentiating criteria' in your next consultation.

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

One could consider a quarterly reporting to the competent authorities containing any transactions which remain unconfirmed in the month following execution.

Such reporting should be automated.

Q14 & Q15:

In addition and more specifically based on the mention 44, it could be optimal to include specific situations of 'anomalies' on the market conditions (e.g. excessive stress) in the scope of the marking-to-model conditions. It could reduce the procyclicality induced by this method.

We believe that the mentioned criteria are sufficient.

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

Should there be any transparency at least towards the CM about the calculation of the Mark to Model by a CCP? (Is more precise than item b)

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

A monthly reconciliation could be appropriate. In the case of a large difference on a margin call an ad hoc reconciliation can be performed.

The reconciliations should be automated by all parties involved.

All portfolios should be reconciled with no minimum limit.

Could ESMA clarify if the limitation will be applied at the Fund level? Or at the Asset Management entity's level?

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

We agree on both the threshold and the frequency subject to ESMA regulates the cost of doing compression or offsetting transactions.

Due to some lack of clarity, could ESMA further clarify the 'portfolio compression' processing for its next consultation?

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

We have already procedures in place for identifying, recording, and monitoring disputes and thus are fine with such proposal.

With respect to procedures and process for resolving disputes in a timely manner, we think the question is if such procedures should be put in place on a bilateral basis between the counterparties or directly set out by the ESMA as a technical standard and replicated by each counterparty. Implementing dispute procedures at the ESMA's level would prevent from having different and heavy procedures in place for each counterparty and would allow a harmonized procedure. Thus we would be of the opinion that the ESMA should set out the details of the procedures and process resolving disputes in a timely manner.

With respect to the timing of resolution, the current market practice is to resolve the dispute in 24-48 hours and a short timing needs to be maintained. If it feels too short, such timing could be extended to 5 days, provided that it covers the entire process (including a third party arbitration or a market polling mechanism), from the day on which a party receives a dispute notice to the day on which the dispute is solved.

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

In case where a legal settlement, third party arbitration and/or market polling mechanism are not sufficient to manage a dispute, we propose that such a dispute is addressed to the CCP or the competent Authority for mediation.

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

We are comfortable with the proposal to report a dispute to the competent Authority provided the Authority has a mediation role as described above - in our views, the question is more on who is going to bear this reporting obligation. We consider that the CCP should monitor it, not the counterparties.

Even if we do not have extended explanations of these thresholds in the current documentation, we believe that these kinds of thresholds should not apply to intra-group transactions.

Q34 & Q35:

Views of NAM's Risk Management Department on Margins (Article 39)

In the cons of point 93, should we add that a too high margining level will have a bad impact on fair competition between big and smaller buy side companies? or, between funds with safe / risky strategies? (Preventing some funds to get some good hedges?)

Point 99: We consider that it is right to force CCPs to use the same liquidation periods (preventing competition on risk management grounds)

Q34: Are the criteria outlined above appropriate to ensure that the adequate percentage above 99 per cent is applied in CCP's margin models? Should a criteria based approach be complemented by an approach based on fixed percentages? If so, which percentages should be mandated and for which instruments?

We believe that a criteria based approach is sensible. The criteria outlined seem relevant subject to more accurate specification of non-linearity, complexity etc.

We do not fully understand the need for a fixed percentages' method. It could be useful to have a more detailed documentation on this particular aspect to build a stronger vision on it and improve our understanding of your methodology.

Q35: Taking into account both the avoidance of procyclicality effects and the need to ensure a balance distribution of the financial resources at the CCP disposal, what it is in your view the preferred option for the calculation of the lookback period?

We think both stable and stress methods make sense. Therefore “c.” looks the most appropriate in our view. However, we think the weighting between stable and stress market condition (or long term period + short term period) shall be discussed, tested in order to be fine-tuned. Equal weighting does not appear to be appropriate to us.

Q36: Is in your view the approach described above for the calculation of the liquidation period the appropriate one? Should a table with the exact number of days be included in the technical standards? Should other criteria for determining the liquidation period be considered?

We agree with the approach described save that the number of days shall remain very low (2 or 3 business days). This number shall be included in the technical docs. We don't see additional criteria to add to this.

Q37: Is procyclicality duly taken into account in the definition of the margin requirements?

We believe that it is reasonably taken into account in Q35.

Q38: What is your view of the elements to be included in the framework for the definition of extreme but possible market conditions?

The elements listed seem broad enough. However, we would like to insist on the correlation between risk factors as outlined in 106. e. In unstable, distressed market conditions, correlation structure amongst asset classes and risk factors may be very unstable and unpredictable. Therefore a range of correlation matrix and impact on correlations between instruments/across markets shall be stressed with a set of situations that has not only been observed in the past but also could be counterintuitive (high positive correlations between non correlated market/instruments).

Q39: Do you believe that the elements outlined above would rightly outline the framework for managing CCPs' liquidity risk?

We do think so.

Q40: Do you consider that the liquid financial resources have been rightly identified? Should ESMA consider other type of assets, such as time deposits or money market funds? If so, please provide evidences of their liquidity and minimum market and credit risk.

Highly liquid Money market funds could be added. They are more suitable than time deposits and represent a more granular credit risk.

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

Yes, we consider the amount of liquid assets kept in cash shall equal at least one third of the contribution to guarantee fund amount. This should in theory cover payments for 1 defaulting clearing member after the use of all margin amounts.

Views of NAM's Risk Management Department on Default Waterfall (Article 42)

114: the CCP itself needs to have a minimum of « skin in the game », and not only rely on margins and default fund contributions of CM. We do not want however, that the CCP's energy or resources be used to find its own capital. The job of the CCP is to be safe for its CMs and their clients.

A proposition could be: the CCP puts 10% (or less...) of the default funds from its own skin, and this amount should not exceed 25% of its capital. And, why not to take into consideration a bank status?

Q44 and following:

Views of NAM's Risk Management Department on Collateral Requirements (Article 43)

In our views, it seems important that if a CM client gives some cash collateral to a CM, the CM shall give the same amount to the CCP.

Regulation has a point when focusing on CM financing one another. The quality of the collateral paid by the client has to be kept. This may be out of the scope of this regulation,

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?

How will “low credit risk” and “low market risk” be defined? We welcome the non-reliance on ratings from rating agencies, but believe more work needs to be done to clarify the concept of “low credit risk” and “low market risk”.

Which type of credit institution would be “low credit risk”? Obviously, any cash held by the CCP would need to be deposited with a credit institution that was very low credit risk. We do not believe that the cash should be deposited only with a central bank, as this would extract large amounts of cash from the financial system.

We would like to see “material wrong-way risk” defined.

Q45: In respect of the proposed criteria regarding a CCP not accepting as collateral financial instruments issued by the clearing member seeking to lodge those financial instruments, is it appropriate to accept covered bonds as collateral issued by the clearing member?

Although our preference would be to limit as far as possible collateral issued by clearing members of owners of the CCP, we agree that covered bond could be considered as a way to avoid cross-collateralisation as members issuing covered bonds are restricted by the amounts of assets in their balance sheet that are eligible to be used as a security. We wonder however which collateral of covered bonds could comply with liquidity criteria. Covered bonds are usually secured by loans to consumers. We don't understand these loans individually comply with the requirement for acceptable collateral as listed in Q44.

In addition, we do not think covered bonds can be liquid in all situations. Thus covered bonds should only be accepted in limited cases.

Q46: Do you consider that the proposed criteria regarding the currency of cash, financial instruments or bank guarantees accepted by a CCP have been rightly identified in the context of defining highly liquid collateral? Should ESMA consider other elements in defining the currency of cash, financial instruments or bank guarantees accepted by a CCP as collateral? Please justify your answer.

The currency of cash shall depend upon the access by the CCP to a central bank. Otherwise we think that cash and financial instrument could also be in a G7 currency. A list of eligible currencies should be reviewed periodically (each year for example) or each time there is a market stress on any of that currencies.

If a CCP clears derivatives denominated in different currency, it should be able to accept collateral on the same currencies subject these currencies are "G7". This may constitute a natural hedge and avoid basis and currency hedging risks.

Moreover, if a CCP is not permitted to hedge its risks using derivatives, how would it manage currency risks? It would be preferable to have ESMA keep a register of acceptable currencies.

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

We agree that these elements are sufficient. As haircuts are applied to mark to market, complexity of pricing of the collateral instruments should be taken into account.

If we agree with the elements set out, and that ESMA should consider a period which incorporates stressed market conditions, it remains very important to make sure that too much collateral is not being posted, as this would mean that significant sums are being tied up for collateral that cannot be invested elsewhere. This will have a direct effect on returns for investors in our funds and on the wider economy.

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?

We agree with the proposed elements.

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

We believe it could be more efficient to oblige CCPs to have access to a Central Bank (via a banking status) thus having the ability to transform assets into cash by giving them as collateral to the central bank...

This would avoid forcing clearing members to put too much cash assets that they would not serve to fund real economy.

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?

As stated above, any percentage for required cash amount shall remain reasonably low as long as CCP can repo the collateral received to a central bank.

We think that the guarantee fund shall be contributed by clearing members in cash for at least a certain amount (one third or half). For Margins, we think the minimum percentage of cash shall remain low and at the discretion of the clearing member.

However, if the clearing member receives cash from a client or counterparty, it shall pass through a certain amount of it. This amount could be something like half of the cash received.

Q52: Do you think there should be limits on the amount of cash placed on an unsecured basis?

In our views, there should be a reasonable limit if this instrument is not eligible as collateral to a central bank.

Q53: Do you consider that CCP should be allowed to invest in derivatives for hedging purposes? If so, under which conditions and limitations?

This could be done only if the hedging policy is strictly defined. Any hedge should offset the risk of the instrument that is hedged with limited basis.

We would have to know more about how a CCP manages its business to provide an informed response. For example:

- What are the risks in the CCPs' business? Risks between the collateral accepted and the transactions? For example: If a trade is denominated in EUR, and the collateral posted is US Treasury Bills/Notes, would the CCP run this currency risk?
- Would it be cheaper for the overall economy for the CPP to hedge its risk or to impose higher haircuts on its members?

Views of NAM's Risk Management Department on Investment Policy (Article 44)

Regarding the question 53, the aim could be to maintain a counterparty risk as low as possible on the CCP.

Q54: Do you consider that the proposed criteria regarding the currency of financial instruments in which a CCP invests has been rightly identified in the context of defining highly liquid financial instruments with minimal market and credit risk? Should ESMA consider other elements in defining the currency of highly liquid financial instruments with minimal market and credit risk? Please justify your answer.

We agree as discussed above even if we would prefer the situation where ESMA publishes a list of acceptable/eligible currencies.

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.

We consider that the framework is robust enough.

Q56: Do you consider that the elements outlined above would rightly outline the appropriate framework for determining concentration limits? Should ESMA consider other elements? Please justify your answer.

We consider that CCPs should delegate this monitoring to an independent third party Asset Manager.

Q57: What are your views on the definitions of back and stress testing?

We agree on the proposed definition. There should be a dynamic relationship between Credit risk and Liquidity in extreme scenarios.

Q58: What are your views on the possible requirements for a CCP's validation process?

We agree on ESMA proposals.

Q59: What are your views on the possible back testing requirements?

We agree on ESMA proposals.

Q60: Would it be appropriate to mandate the disclosure of back testing results and analysis to clients if they request to see such information?

We agree on ESMA proposals.

Q61: Should the time horizons for back tests specified under 144(e) be more granular? If so, what should the minimum time horizon be? Should this be different for different classes of financial instruments?

We agree on ESMA proposals.

Q62: What are your views on the possible stress testing requirements?

We agree on ESMA proposals.

Q63: Would it be appropriate to mandate the disclosure of stress testing results and analysis to clients if they request to see such information?

It would be absolutely appropriate. Either the results are available solely to regulators or to all market participants. ESMA should not create a situation where Clearing members have insider information regarding prices a CCP, this would lead to distortion of competition

Q64: What are your views on the possible requirements for reverse stress tests? And what impact do you think such requirements would have on industry?

It is important in our views that ESMA conducts (or asks to) CCPs to conduct many kinds of extreme stress tests. But we do not understand the consequence of these tests. These are so extreme that if they are seen by market participants, there could create some panic in the system. OTC derivatives are leverage thus extreme tests may show collapses in the system.

Q65: Should there be any other parties involved in the definition and review of tests? Please justify your answer and explain the extent to which suggested parties should be involved?

The suggested parties could be ESMA plus regulators and a pool of market participant after conducting a request for comments on assumptions.

Q68: In your view what key information regarding CCP risk management models and assumptions adopted to perform stress tests should be publicly disclosed?

Transparency is absolutely key. All the assumptions should be disclosed as well as the technical documents about the models.

[Views of NAM's Risk Management Department on Information to be publicly disclosed \(CCPs\)](#)

We consider that publicly disclosed stress tests are a good step towards a stronger system.

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?

Regarding the identification of derivatives products, it could be helpful to associate data vendors (such as Bloomberg) in the consultation in order to determine a common, unique and jointly shared codification. It does not seem manageable for teams in charge of internal data repositories to manage specific and dedicated proprietary codes depending on the internal codifications of counterparties or intermediaries.

MarkIt RED codes are an interesting tool. It should be a code that combines an ID specific to the instrument and another one specific to the underlying curve (issuer, IR curve, Currency etc.)

Question 75: Would information about fees incorporated into pricing of trades be feasible to extract, in your view?

We do not believe it would be easy or useful to force banks to have to split their pricing into different elements.

Views of NAM's Risk Management Department on fees (Article 44)

Information has a cost. We do not believe that this cost is an added value for the system as a whole.

Question 76: what is your view of the granularity level of the information to be requested under these fields and in particular the format as suggest in the attached table?

The attached table replicates to a large extent the elements that would be found in the confirmation of a derivative transaction. If the purpose of reporting to trade repositories is to ensure that market authorities have a view on the systemic risks that are building up in the system, than the amount of information required is excessive. Presumably, all the market authorities need to know are the type of transaction, the nominal amount and the names of the entities concerned. Regulators can also contact a particular counterparty if they require further information.

Alternatively, as is currently the case with CDS, the trade repositories could be used as the means to electronically confirm transactions and as the means of giving market authorities an overview of the market.

Question 78: Given that daily mark-to-market valuations are required to be calculated by counterparties under 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?

For cleared transactions, it would be more efficient for the market authorities to obtain this information directly from the CCP.

For non-cleared transactions, it would make sense for counterparties to report on a monthly basis.