POLISH BANK ASSOCIATION

Comments
on ESMA Consultation Paper – Draft technical Standards
for the Regulation on OTV derivatives, CCPs and Trade Repositories
(25 June 2012)

The Polish Bank Association (Związek Banków Polskich) is a self-governing association of banks in Poland. The ZBP has been established in January 1991 and operates under the Chambers of Commerce Act of 30 May1989. The Polish Bank Association's mission is to:"contribute to conditions for sustainable development of the Polish banking system, help the banks' in their activities supportive of economic growth in Poland and of the single European market for financial services, and to strengthen the role of Polish banks". The ZBP membership is voluntary and comprises banks operating in Poland, incorporated under Polish legislation. The Polish Bank Association gathers 107 commercial banks, branches of credit institutions and cooperative banks whose assets represent more than 95 percent of the Polish banking sector

I. CLEARING OBLIGATION PROCEDURE

1. According to EMIR, a competent authority shall notify ESMA when it authorizes a CCP to clear a class of OTC derivatives. Having in regard that the potential clearing obligation will affect contracts executed as of the date of the notification, **we would like to stress the importance of the market participants to be informed about such notifications as soon as practicable, to make appropriate arrangements to be able to prepare themselves to clear such contracts**. PBA understands ESMA's position, that only a portion of those notified contracts will finally become mandatory clearable. It is, however, worth stating that market participants will have the ability to asses themselves the probability of the class of OTC derivatives to meet relevant criteria, and make informed decisions regarding starting preparation works or not. Even if the given class of OTC derivatives will not qualify, the benefit of having extra time in all those cases where it will finally become mandatory clearable is worth considering. It will also mean that the process will be more transparent, and will enable the participants to more closely monitor

also the contracts that not qualified at the first time, but may be submitted again in the future.

2. Regarding the review process following the negative assessment, we are of the opinion that the possibility to submit the repeated notification, with respect to the same class of OTC derivatives should be allowed only, when the competent authority is informed that market conditions, or any information provided to ESMA **change in material way**, allowing to asses that such change will likely to affect prior negative assessment. We also support the view that sufficient time should elapse in between assessments to avoid workload of the participants and to avoid situations where ESMA will have continuously disagree to repeated notifications of the same class of the OTC derivatives on the same reason. We note however, that it is possible that a need to clear certain class of derivatives may emerge shortly after first negative assessment, and due to the market conditions, could be potentially urgent – in such circumstances we consider that ESMA should perform a top-down approach, with an existing CCP already authorized to clear such contracts.

3. We understand that, if in assessing the liquidity as a criteria defined in Article 5-4 of the EMIR (as described in section 35 of the RTS), margins applied by the CCP will be deemed to be disproportionate, it will result in ESMA's establishment of lack of liquidity of such class of OTC derivatives, and therefore such class will not be subject to mandatory clearing. We understand also, that both criteria of volume and liquidity should be met cumulatively to enable the class of contracts to become clearing eligible.

II. NON-FINANCIAL COUNTERPARTIES ("NFC")

1. In relation to criteria for establishing which derivative contracts are objectively measurable as reducing risk directly related to the commercial activity or treasury financing, we would like to stress **that certain level of uncertainty may arise when using the criteria of IFRS hedge accounting**. First of all, basically in accounting use of that method is voluntary, which means that some NFC's may not have it introduced in their course of business. As a result they may not be able to benefit from exclusion of the executed contract which do not qualify under Chapter VII Article 1.1.a and 1.1.b of the draft regulation with regard to regulatory technical standards on OTC derivatives (Annex II) ("OTC draft Regulation"). To be able to qualify a contract as a "hedge" under IFRS, the NFC would have to test *inter alia* effectiveness of the hedge in accordance with the hedge accounting principles, which also means that effectively to be able to use that criteria, in practice one that did not have a hedge accounting introduced will need to introduce it to be able to process that monitoring. The other thing is that some level of unclarity may arise

also in those events were the hedge accounting is introduced and required back-testing resulted in finding that the hedge stopped fulfill required effectiveness criteria under IFRS. We understand that in such case no back-effect will take place and the contracts that ceased to be "hedge" under IFRS will not be accounted for clearing threshold purposes as of the date of their execution, but as of the date of back-test.

2. We understand the necessity to set out the sample to implement model for calculation of the clearing threshold, but we would like to underline that the **notional value reference will not necessarily properly address the issue of the exposures** that arisen in the course of the cooperation of the NFC with the market participant.

3. We see a need to clarify who is responsible to monitor and report exceeding the clearing threshold – we would like to point out that it will be impossible for the financial counterparties to monitor thresholds of the NFC, as it is a common market practice that the entrepreneurs are executing OTC derivatives with more than one financial institutions. Furthermore, monitoring by financial institution of the contracts and assessing whether they should be included in the threshold, or for example exempt as executed as a hedge will be very often impossible, as the necessary information on the possible criteria fulfilled will be with the NFC. Lack of the regulation may result in the financial institution entering in good faith in the OTC derivative contract with NFC, who did not inform the counterparty about the clearing threshold that has been exceeded triggering clearing obligation. **PBA assumes that it should be sole responsibility of the NFC to monitor and inform where appropriate about exceeding the clearing threshold.** The financial institution may use its reasonable endeavors, but should not be held liable in the above described event. Lack of certainty with that respect may adversely impact the market. In the event ESMA considers appropriate to make financial counterparties responsible for monitoring of the thresholds, it would be necessary to give them tools that would enable them to effectively achieve that goal.

III. RISK MITIGATION FOR OTC DERIVATIVES NOT CLEARED BY A CCP

1. In relation to the requirement of timely confirmation, in accordance with Article 11.1 of EMIR PBA would like to underline that additional guideline is necessary to clarify **what ESMA would deem as sufficient to fulfill the confirmation obligation**. Having in regard strict timeframes for confirmation of the trades as proposed in the Chapter VIII, Article 1 of the OTC draft Regulation, **it is vital to have clarity in this respect**, as the market practice varies from country to country and in some cases it is deemed sufficient to have a confirmation sent or presented via electronic means to the counterparty, in other cases it is sufficient to have the confirmation sent or presented via electronic means and not contested within

given period of time, and in other it is necessary to receive explicit statement confirming all the terms of the confirmation. In our opinion the standards set – out in the Chapter VIII, Article 1 of the OTC draft Regulation may, in Polish practice, be used in relations with financial counterparties, or with most sophisticated NFC's. In all other cases **compliance with those standards would very likely mean a Polish competent authority to receive tons of the notifications of unconfirmed contracts (see also below).**

2. According to the "Recommendation A" by Polish Financial Supervision Authority (Komisja Nadzoru Finansowego – "KNF"), the trades executed over the phone **must be confirmed on the durable medium**. At the same time, KNF requires financial counterparties to "*have a mechanism of creating and safekeeping of the **documentation containing the confirmation by the client** of the accuracy of the executed contracts*". To comply with the above requirements, many financial counterparties in Poland have in place the documentation that provides for sending to clients written confirmations, and the obligation of the client to verify, sign and send back the document to the financial counterparty for safekeeping or in other way requiring positive action by the client to confirm the terms of the contracts. There are also procedures in place to monitor the confirmation process and to contact clients where the confirmation did not take place for reasons on the client's part. In many cases it is hard to receive back the "confirmation" from the NFC for period of time much longer than one day, especially when dealing with NFC's without selected unit responsible for treasury operations of the counterparty (most SME and vast part of the Polish corporate NFC's). In such case, such contract, even if it is not subject of the dispute with the client, would be deemed as unconfirmed in accordance with that regulation.

3. It is worth underlining that the above confirmation procedures proved to be very efficient in reducing a risk of disputes with the NFC's on the Polish market in past few years. It is much harder to contest the terms of the trades, if the counterparty may produce a document which clearly and undoubtedly was positively verified by the NFC, which – in addition – did have sufficient time to analyze it and make a informed decision. It is therefore profitable, to be able to keep it, at least in relation to those less sophisticated NFC's.

4. In some cases, financial counterparty needs to meet specific requirements of the NFC and prepares a bespoke product that does not have a pre-agreed internally format of the confirmation. Such confirmations need to be prepared once all parameters of the contract are agreed (execution of the contract takes place usually by the phone) and such preparation involve the engagement of the front-office, back-office and legal units responsible in accordance with internal procedures. In such cases, which occur quite often, the process of producing the relevant confirmation will likely exceed the

times set-out in the OTC draft Regulation for the whole confirmation process, when presenting the prepared confirmation to the NFC will only start the confirmation procedure (see also above).

IV. PORTFOLIO RECONCILIATION

It is our view that the requirement to make a portfolio reconciliation at least once a month for a portfolio of fewer than 300 OTC derivatives will be very burdensome for financial counterparties, and at the same time not very useful from EMIR perspective. It is worth mentioning that such requirement in Poland will affect the SME and not sophisticated NFC's market, where counterparties are mostly dependant on the information received from the financial counterparties. In the situation where all contracts has been appropriately confirmed between the counterparties, the reconciliation should take place only in the event there is a discrepancy notified by either counterparty.

V. PORTFOLIO COMPRESSION

With respect to the portfolio compression standards PBA supports the view that such compression should take place only when compression would not adversely effect the level of the risk that was hedged by the contracts with given counterparty. In practice, vast majority of the contracts executed by the financial counterparties in Poland are aimed to hedge one of the risks associated with the commercial activity of the counterparty – such link means that pre-mature termination of given contract may expose the counterparty to additional risks, which seems not to be a purpose of that exercise.

VI. REPORTING OBLIGATION

1. PBA welcomes ESMA's view on the objectives of EMIR which are **clearly aimed at improving transparency in derivatives markets, protection against market abuse and systemic risk mitigation**. It is very doubtful however, whether ESMA's mandate under EMIR includes to, **by the means of the technical standards**, to broaden the scope of the Article 9.5 of EMIR, and to set a new set of objectives, including monitoring the firms compliance with other requirements of EMIR, including the clearing exemption.

2. According to Article 9.5 of EMIR the reports referred to in paragraphs 1 and 3 of that Article shall specify at least:

    a) the **parties** to the derivative contract and, where different, **the beneficiary of the rights and obligations** arising from it;
    b) the **main characteristics** of the derivative contracts, including their type, underlying maturity, notional value, price and settlement date.

The ESMA's mandate includes development of the technical standards specifying the **details and type of the reports** for the different types of the derivatives.

3. As it results from the above provisions, ESMA should develop technical standards related to two group of information regarding contracts, which are: (i) data related to the parties, or (if applicable) beneficiaries of the rights and obligations, and (ii) main characteristics of the derivative contracts, sorted per different classes of derivatives. EMIR specifically stressed, that only main (and not all, or almost all) characteristics should be reported. When developing standards ESMA should choose those details, which are covered by one of those two groups, which serve the EMIR purpose of the improving transparency in derivatives markets, protection against market abuse and systemic risk mitigation and not more. **Especially, the fields related with ESMA's goal to monitor the compliance of the firms with EMIR, and in particular – clearing obligation, are in our view beyond that scope and should be removed**. They also may be practically difficult to fill in by financial counterparties, as for example the information on the nature of the trade (whether it is linked directly to commercial activity or treasury financing), or about exceeding clearing threshold may not be disclosed to such counterparty at the stage of preparing the report (see also the remarks under "NFC's" in section II above) or even not disclosed at all. We also see that it will be difficult to, at the stage of preparing the report, fill the data required to monitor exposure – in regular process, for the purpose of the variation margin calculation, exposures are being accounted for the end of the business day and margin call are being made the following day, which is the day after the report will be prepared. The fields regarding the collateralization (27-29) are requiring information on the past actions ("exchange occurred" "is posted") which are likely to not happen at the time of the report. Some of the information (for example "time and date clearing took place") will not be possible to report by the counterparties other that CCP's.

4. When reviewing the table in Annex V to RTS it is also worth underlining that implementation of the reporting obligation of such huge scope will be extremely difficult for operational reasons, and will very likely cause the rise of the risk of occurrence of mistakes in the reported data, not to mention additional resources costly resources needed to be able to gather, process and report the data from many units in short time prescribed for delivery of the report, while still carrying huge risk of non-compliance due to the above reasons. As a matter of example we would like to point out that, according to the information gathered in the process of discussion of the RTS in Poland, we found out that in some financial organizations in Poland the data as required to be reported in the RTS would need to be collected from:

a) Treasury Front-Office
b) Treasury Back-Office
c) Legal Department
d) Back-Office Control Unit
e) Treasury Product Control

Warsaw, 27 July 2012