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Frankfurt, 3. August 2012

Comments Consultation on the Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories

Dear Sir or Madam,

DZ BANK AG appreciates the opportunity to respond to ESMA's Consultation on the Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories.

Please find our comments below.

Yours faithfully

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DZ BANK AG

1. Risk Mitigation techniques for bilateral transactions (Art. 1 to 8 RM)

1.1 Art. 1 RM para. (2) – timely confirmation

We concur with the time limits proposed and the general concept regarding the confirmation of transactions. However, this is based on the understanding that "confirmation" in this context interpreted in line with current practice as the (first) confirmation of the key terms by one of the counterparties and not any response to such confirmation from the other counterparty. We also assume that it is not expected that such confirmation covers all aspects of the transaction in minute detail but focusses on the key terms.

The present draft delegated regulation currently lacks a definition of the term "confirmation". The term "confirmation" is, however, defined in Art. 2 (4) the draft delegated regulation in Annex V. It is, however, not clear, whether the definition in that delegated regulation is to apply directly or indirectly to Art 1 RM. Moreover, the definition in Art. 2 (4) the draft delegated regulation in Annex V is not compatible with the function and understanding of "confirmation" as currently applied in practice (in particular in the context covered by Art. 1 RM), see also comment to Annex V below. To avoid any uncertainty over the understanding of the term "confirmation", we suggest that it is defined in line with the above described understanding and also uniformly for the purposes of all delegated regulations (ideally in single section on definitions applicable to all delegated regulations to avoid uncertainties, see general comments under item B above).

The words "which is not cleared by a CCP" are misleading and should be replaced by "which are not to be cleared": The clearing of a transaction (that is its entering into the clearing system of a CCP) follows after the conclusion of the contract.

At least it will be necessary to define what is to be understood under "where available". Availability should only be assumed where an electronic system can be reasonably expected taking into account the trade volume on the one hand and the cost of implementing and maintaining such system on the other.

1.2 Art. 1 RM para. (3) – timely confirmation

The time required for an electronic confirmation can differ considerably depending on the type of transaction and market participants involved. In particular less sophisticated market participants (which would include a significant portion of market participants falling under the definition of financial counterparty in particular small and medium sized banks) will have a significantly less developed infrastructure (human resources, system capacity) for the processing of transactions and thus will generally require more time for processing transactions.

Small financial and non-financial counterparties with a limited range of derivative exposure should not be forced to implement and perform a confirmation process through electronic platforms. In any event, the benchmarks set by highly sophisticated market participants and in relation to simpler transactions should not set the standard for all confirmations (electronic or non-electronic).

The time limit proposed under Article 1 RM para. 2 appears to be based on benchmarks set by highly sophisticated market participants and in relation to simple transactions and thus cannot be applied to all market participants and in relation to all types of transactions (in particular bespoken transactions). Against this background, a limit of 5 days would be more realistic and ensure a higher quality and efficiency of the confirmation process with regard to non-electronic confirmation of less sophisticated market participants. We suggest therefore the following amendment of Article 1 RM para 2:

" ... of the same business day. In case of non-electronic confirmation the OTC derivative contract should be confirmed at the latest by the end of the fourth business day following the business day of the transaction."

Besides, to avoid uncertainties we suggest introducing a definition for the terms "business day" and "local time". In both cases this should be the day and time at the place where the confirming party is situated.

1.3 Art. 2 RM para. 4 lit a. and b. – thresholds for portfolio reconciliation

The requirements regarding portfolio Reconciliation should not be applicable (or deemed to be fulfilled) where the consistency of the respective information is already ensured by other means, such as the use of matching services.

To recognize the fact that smaller institutions have often just a single-digit number of OTC derivative contracts with low amounts the following "de-minimis"-threshold should be added to Article 2 RM para 4 lit. b.:

"iii. Once per year for a portfolio between 1 and X (e. g. 50) OTC derivative contracts outstanding with a counterparty."

1.4 Art. 3 RM – threshold for portfolio compression

Under the current proposal the counterparties would be required to prepare "a reasonable and valid explanation" to be presented to the competent authority (if so requested) in the event the counterparties deem a compression exercise inappropriate.

Portfolio compression can only cover certain of the relevant counterparties' own positions, never the complete portfolio. For example, positions required for specific hedging purposes need to be maintained. Therefore, the total number of transactions which may be eligible for compression may be significantly lower than the total number of transactions outstanding between two counterparties. The conclusion that a compression exercise is not appropriate may therefore be not an exceptional but rather common occurrence.

There are software providers in the market offering the portfolio compression functionality. Those providers are already used by many market participants for economic reasons. However, the offered functionality is restricted to standardised products (in particular, interest rate derivatives and CDSs), so that a full product coverage cannot be ensured. An additional in-house implementation would result in significant efforts which should be avoided.

We ask for clarification, e.g. in the recitals, whether the threshold of 500 or more OTC derivative contracts in Article 3 RM para. 2 shall be applicable to financial and non-fincial counterparties.

1.5 Entry into force/phase-in

The obligations under Art. 11 of the regulation regarding risk mitigation techniques for transactions not cleared by a CCP (bilateral transactions) will cause significant and far reaching changes to operational processes. Market participants will not be able to implement the new requirements immediately. Recital 93 of the regulation already clarifies that obligations arising under the regulation which are further developed by implementing acts, in particular technical standards, will only apply as of the date the relevant regulations or acts on level 2 defining these obligations start to apply.

While this at least clarifies that the obligations regarding risk mitigation techniques for bilateral transactions do not become applicable before the technical standards defining the actual content of the obligations come into force, this will still not resolve the problem that the implementation of the new requirements can only be initiated on the basis of the final technical standards. Thus, the addressees of these requirements need a certain period of time following the finalisation of the technical standards to adjust their processes to these new requirements.

Although the regulation does not explicitly provide for the introduction of an implementation/transition period as part of the relevant technical standards, we strongly believe that such transition period is necessary. We therefore expressly welcome that that ESMA has been consulting with the European Commission whether it will be possible to introduce such transition period.

1.6 Art. 4 RM para. (2) – dispute resolution

In respect of the proposed obligation to agree on "detailed procedures and processes" it should be taken into account that counterparties must retain the requisite level of flexibility to agree on standards and terms corresponding to their specific needs and legal background. In particular, non-financial counterparties need simple and robust procedures and would have difficulty in subjecting themselves to highly complex dispute resolution mechanism or dispute resolution mechanisms resulting in the application of the laws of another jurisdiction. Consequently, any requirements to be defined cannot follow one specific model solution.

There should be some clarification on the scope of this Article: It should be clearly stated that the dispute resolutions are required for the margining/ collateral process only.

1.7 Art. 5, 6 RM – marking-to-market and marking-to-model

Generally we concur with the content of Articles 5 and 6.
However, the first bullet point of Article 5 should be clarified. In particular, it is not clear to which situations this bullet point applies (As soon as probabilities are relevant, a mark-to-model environment is concerned rather than a mark-to-market. If the term "probabilities" is aimed at indications given by traders for non-tradeable products, then an inactive market exists which is already described by the first bullet point).
Moreover, Article 6 a., requires to incorporate all factors that counterparties would consider in setting a price. Of course, mark-to-model valuations should not only incorporate the counterparties' factors but instead also all those parameters that are relevant for the bank's individual situation.

1.8 Art. 7 RM – definition intra-group transactions

Along the lines of Art. 7 RM para. 1 we share ESMA's reading that intragroup transactions within a Member State and without any impediments for the transfer of funds are not to be notified to the competent authority because they are exempted from the clearing obligation in general in the level 1-text. Art. 4 para. 2 subpara. 1 of the regulation releases a general exemption whereas subpara. 2 lit. b refers to the cases of cross border transactions within and outside of the EU.

Irrespective of the remarks above, it should be expressly set out in Art. 7 RM that the relevant notifications do not have to be made individually, in respect of each transaction but rather in form of a general notification covering all transactions of the relevant group members.

General Comment

DZ BANK agrees to ISDAs letter as of July 30, 2012 to ESMA pointing out, that clearing member of existing CCPs should not be discriminated against other market participants. In general we see the CCP market dominated by CCPs outside the EUR Zone and the Clearing Member business dominated by the mayor banks. For these mayor banks many of the EMIR-Regulations are easier to be fulfilled using the economies of scale in their business.