EACB answer to the consultation of the European Commission on possible initiatives to enhance the resilience of over-the-counter derivatives markets

31 August 2009

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4.200 locally operating banks and 63.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 160 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 50 million members and 750.000 employees and have a total average market share of about 20%.

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General remarks

1. The European Association of Co-operative Banks (EACB) would like to thank the European Commission for the opportunity to respond to its consultation on possible initiatives to enhance the resilience of OTC derivatives markets.

2. EACB supported from the beginning the calls for more transparency and stability in the derivatives markets as outlined – amongst others – in the report of the "de Larosière"-group (February 2009) and in the conclusions of the G20 summit in London (April 2009) as well as of the European Council (June 2009).

3. EACB has been actively involved in the debates on derivatives in general and on credit default swaps (CDS) in particular and contributed with the in-depth expertise of its derivatives experts to the recent discussions. EACB was active in several fora including the working group on derivatives of the European Commission and the numerous meetings organised by the European Central Bank on the matter.

4. With respect to the central clearing of CDS, major European co-operative banks active in this field adhered to the so called "Small Bang" protocol by transmitting their signature to the International Swaps and Derivatives Association (ISDA).

5. In the following outlines EACB would like to point out responses to selected questions raised by the Commission in its consultation document:

Standardisation

(1) What would be a valid reason not to use electronic means as a tool for contracts standardisation?

6. In this respect two perspectives should be taken into consideration, the viewpoint of the market players and their size as well as the viewpoint of the products.

7. Size of the market players: For small and medium sized market participants the use of electronic means as a tool for contracts standardisation leads to significant efforts. With this respect a *de minimis* rule is required in order to avoid that with the high fixed costs the break even point for the market entry leads to an exclusion from the market.

8. Products: Another reason would be valid for products with a certain degree of outstanding notional volume that makes them improper for any electronic contract standardisation. A good example would be Single Tranche CDOs with a minor overlap to standard iTRAXX Tranches or Credit Linked Notes with very specific embodiment.

(2) Should contracts standardisation be measured by the level of process automation? What other indicators can be used?

9. Process automation and contract standardization relate to each other. Therefore the level of process automation is a measure of the standardisation. Common roll dates, general contract durations, general interest rates – amongst others – can be parameters for the contract standardisation.

10. The "Big Bang" protocol in the US and the "Small Bang" protocol in Europe have led to a high degree of standardisation which is for us the basis for a high degree of process automation.

(3) Should non-standardised contracts face higher capital charges for operational risk?

11. No. Only a positive proof of correlation between non-standardised contracts and operational risk would justify different capital charges for standardised contracts and non-standardised contracts.

(4) What other incentives toward standardisation could be used, especially for non-credit institutions?

12. No answer.

Strengthening bilateral collateral management

(5) How could the coverage of collateralised credit exposures be improved?

13. No answer.

(6) Are there markets where daily valuation, exchange of collateral and portfolio reconciliation cannot be the goal? Please justify.

14. We don't see any problem between banks, where the exchange of collateral via CSA is standard. Where we do see problems arising is for certain market participants (like hedge funds) who often use illiquid securities or positions for their strategies. In this case daily portfolio reconciliation can be considered as a problem.

15. The same comment applies to corporates, which are not necessarily willing to manage margin requirements over the life of a hedged transaction for example.

(7) How frequently should multilateral netting be used?

16. Frequency depends on the size of the market participants. Concerning bilateral clearing, one time per day is standard for large banks under CSA. The frequency should decrease with decreasing size of the market participant and vice versa taking into account technical efforts and costs.

17. Concerning trade compression, it is the industry's interest to continue multi-lateral trade compression, in particular with TriOptima for interest rate derivatives; no particular frequency is applicable to all products and players.

(8) Should bilateral collateral management be left to self-regulatory initiatives or does it need to be incentivised by appropriate legislative instruments?

18. For the time being, bilateral collateral management should be left to self-regulatory initiatives (recently the ISDA Collateral Committee, a forum for industry engagement on collateral management, published its "2009 ISDA Protocol for Resolution of Disputed Collateral Calls"). In general methods for the reduction of risks are very relevant for the market and provide incentives for self regulation.

Central data repository

(9) Are there market segments for which a central data repository is not necessary or desirable?

19. No. Full information and transparency should be the primary goals.

(10) Which regulatory requirements should central data repositories be subject to?

20. A central data repository within the European Union – supervised by European competent authorities – would be desirable.

21. A US central data repository may be considered only in so far:

    - It is accessible to European competent authorities under agreed terms;
    - Strict security protection measures are implemented and negotiated with European competent authorities.

(11) What information should be disclosed to the public?

22. Aggregated information should be disclosed as granular as possible but the public should not have access to any counterparty specific information. We do not see the need for further reporting obligations besides the existing ones.

CCP clearing

(12) Do you agree that the eligibility of contracts should be left to CCPs? Which governance arrangements might be necessary for this decision to be left to the CCPs' risk committees?

23. The eligibility of Credit Default Swap contracts should be established in a joined assessment by market participants, ISDA, the CCPs and the competent regulators.

24. Reasonable would be a supervisory board – that consists of the parties mentioned in paragraph 23 – enabling to incorporate a broad market view for future developments or to resolve possible disputes.

25. Preference should be given to central bank money as opposed to commercial bank money.

(13) What additional benefits should the CCP provide to secure a broader use of its services?

26. None. We do not see any requirement for CCPs to provide financial markets with further and/or additional benefits, as we consider serving markets with multilateral exposure netting and mutual insurance against counterparty defaults as already ample tasks.

(14) Is the zero-risk weighting a sufficiently effective incentive for using CCPs across different market segments?

27. Yes. Especially taking into account the respective regulatory capital savings under Basel II.

(15) Should additional requirements, such as appropriate account segregation, be introduced to apply the zero-risk weighting to indirect participants?

28. Yes. Without proper and appropriate account segregation Zero Percent Capital Risk Weighting does not seem viable; moreover, without proper and appropriate account segregation, the Buyside would not have any compelling argument to clear centrally as a Non Clearing Member. Without proper and appropriate account segregation the Sellside as General Clearing Member would not be able to attract customers for an indirect clearing service.

(16.1) Should bilateral clearing of CCP-eligible CDS be penalised and, if so, to what extent?

29. No. Bilateral clearing of CCP-eligible CDS should not be penalised. Trades with SMEs and smaller credit institutions can be CCP-eligible with those parties having no access to a CCP.

(16.2) Is there a need to extend regulatory incentives to clear through a CCP to other derivatives products?

30. No answer.

(17) Under which conditions should exemptions be granted and by whom?

31. Possible conditions could be the number and the volume of the outstanding contracts and/or a minimum level of trades per month or week. Those exemptions should be established by the competent authorities who should consult representative industry associations and larger banking institutions depending on the concrete market developments.

32. The grant of exemptions is a very good example of a topic to be dealt with in a supervisory board as outlined in paragraph 23.

(18) What is the minimum acceptable ratio of CCP cleared/ eligible contract? What is the maximum acceptable number of non-eligible contracts?

33. Due to the heterogeneity of the market participants – their size, strategies and trading activities – it is not possible to give a universally valid answer to this question.

34. An estimation could be carried out taking into account the conditions mentioned in paragraph 31. A market with a similar heterogeneity could be used as a benchmark to give an indication for minimum or maximum figures.

(19) What statistics need to be provided to regulators to make sure they have all the information necessary to perform their duties?

35. Regulators should request aggregate exposure to entities across all products, with precise info on an individual trade basis; this is key to follow risks

(20) How could European legislation help ensuring safety, soundness and a level playing field between CCPs?

36. The highest priority for European legislators should be to ensure a competition between different providers for the clearing of CDS. A monopoly in this field should be avoided. As soon as competition is ensured, European legislators could think of further measures (e.g. Code of Conduct, CESR/ESCB recommendations, etc.).

37. Alternatively, a user owned, user governed and not for profit model (à la DTCC) is desirable. Last but not least, it is critically important to ensure a US/EU level playing field, an absence of duplication, the protection of data and respect of sovereignity with IOSCO consistent regulations negotiated between relevant regulators.

Transparency requirements

(21) Should MiFID-type pre- and post-trade transparency rules be extended to non-equities products? Are there other means to ensure transparency?

38. The discussed central data repositories provide for an adequate transparency in the derivatives market on an aggregated level. Reporting obligations ensure an extensive insight view for the competent authorities in Europe.

39. The pre- and post-trade transparency rules as outlined in the MiFID deal with the protection of retail clients. Investors in OTC derivatives markets are professional, institutional clients; there is no relevant retail business in this field. As a conclusion we do not see any need for an extension of MiFID-type transparency rules and trade reporting obligations for derivatives.

(22) How should transaction reporting of OTC derivatives to competent authorities be envisaged? Should it be extended to all contracts or to certain categories? If so, which ones? Are there other means to ensure that the competent authorities receive the relevant information on OTC derivatives transactions?

40. For the CCPs daily and for the rest quarterly.

(23) How should position reporting of derivatives to competent authorities be envisaged? Should it be extended to all contracts or to certain categories? If so, which ones? Are there other means to ensure that the competent authorities receive the relevant information on the exposures to particular contracts?

41. No answer.

Public trading venues

(24) How can further trade flow be channelled through transparent and efficient trading venues? What would be the appropriate level of transparency (price, transaction, position) for the different derivatives markets?

42. The main benefits of the derivatives business – like flexibility, customer orientation and rapidity – would be lost by a channelling of the trade flow through standardized trading venues.

43. A solution with less restrictive prerequisites – like multilateral trading facilities (MTFs) – might be feasible.

Conclusion

44. EACB would like to highlight that it stands ready to contribute with the in-depth expertise of its experts to the development of further measures in the field of OTC derivatives that are envisaged by the European Commission.

Contact:

The EACB trusts that its comments will be taken into account. For further information or questions on this paper, please contact:

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