European Association of Co-operative Banks comments on

Consultation Paper

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

Ref.: ESMA/2012/379 (25 Jun 2012)

26 Jul 2012

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 4.000 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 181 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 51 million members and 750.000 employees and have a total average market share of about 20%.

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Detailed Remarks

The Members of the European Association of Co-operative Banks (EACB) are pleased to comment on ESMA's *Consultation Paper* on *Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories*.

We have focused our answers mainly on the topic of OTC Derivatives (Section III and ANNEX II) of the Consultation Paper and are following the structure of the annexes in our comments. We would greatly appreciate, if our detailed views and comments are taken into account in the final preparation of the draft technical standards.

ANNEX II

Chapter II: Clearing obligation

Chapter II (Indirect clearing arrangements)

With regard to indirect clearing arrangements ESMA seems to have overlooked a case that is typical for two counterparties – both being on the buy side and often of medium size: Two clients of two different clearing members of a CCP conclude an eligible swap contract which is to be cleared in principle, but the current situation does neither allow the central clearing nor the matching of respective affirmation because of the lacking technical prerequisites on the side of the CCP. For these cases there should be no obligation for clearing the transaction, as the situation is comparable to the case of a CCP not being able to clear a transaction, until the necessary requirements to fulfil the clearing obligation are present. Otherwise, a discrimination of indirect clearing members and therefore of an important part of the market would take place and hamper competition.

Art. 2 ICA para.1 (Authorisation of client of a clearing member to provide clearing services)

The paragraph indicates that "The client of the clearing member is subject to appropriate regulatory requirements, including authorisation". We are of the opinion that clarification on the type of authorisation, the competent authority required to grant the authorisation and the specific time frame for such authorisation is needed.

Art. 2 ICA para. 2 (Honouring obligations following default)

The paragraph indicates that with regards to indirect clearing arrangements that "clearing member[s have] to honour any obligations between the client and its indirect clients following the default of the client". We regard this, at least, misleading, as a contractual arrangement between the client and the indirect client cannot be binding

upon the clearing member. The agreement between the two parties can therefore only contain provisions setting out an obligation of the client to ensure that the client enters or has entered into a contractual agreement with the relevant clearing member which adequately addresses the consequences of a default of the client on behalf the indirect client and the relevant transactions.

Furthermore, we would value further clarification on the type of authorisation needed in order to provide indirect clearing arrangements.

Art. 3 ICA para. 1 (Single aggregated indirect clients' account)

We would like to underline that we agree with ESMA's indirect clearing proposal to provide separate account for client and indirect client's assets at CCP level.

Art. 4 ICA para. 1

We believe it necessary to clarify that the clearing member is bound to accept and facilitate, on a non-discriminatory basis, indirect clearing arrangements when occurring under rules of the EMIR regulation (Art. 4 para. 3).

Art. 4 ICA para. 3 (No exposure to losses in case of default)

The paragraph refers to Article 39 paragraph 9 of the EMIR regulation to define the requirements that need to be met, with regards to the obligation to distinguish in accounts with the clearing member the assets held for indirect clients. One of these requirements is the obligation to ensure that the positions recorded in an account "are not exposed to losses". In practice, this will primarily concern collateral posted by the indirect client (specifically, the initial margin) and passed on to the CCP. As this collateral in form of the initial margin will be posted most likely be in cash, it is nearly impossible to distinguish this cash transaction from other assets of the party receiving the cash payment. Secondly, even if the initial margin is collateralised by securities, variation margins will still require cash which then poses the same problem as above.

As long as there are no harmonised special provisions in the EU requiring national laws to protect client positions in view of the specific circumstances of client clearing against the consequences of an insolvency of the account holder, national insolvency laws will always override any contractual arrangement. It will therefore not be possible to ensure complete protection by contractual means alone.

Art. 4 ICA para. 7 (Conflict of interest)

As rightfully stated in the paragraph, the potential conflict of interest between the clearing member and it offering indirect clearing services should be properly administered. Adequate safeguards should be in place that information regarding indirect clearing arrangements (including information about the clients of the client offering indirect clearing) remains with the staff of the clearing member responsible for these indirect clearing arrangements.

Chapter III: Clearing obligation procedure – Notification to ESMA

Art. 1 DET para. 1 (Details of CCP application)

We'd think suitable that in the CCP's application to the competent authority, under article 14 of the Regulation EMIR, the CCP has to declare that it will accept as clearing member only counterparties which accept, in turn, the indirect clients too

Chapter IV: Criteria for the determination of the classes of OTC derivative contracts subject to the clearing obligation

Art. 1 CRI (Covered Bonds)

Under Recital 16 of the EMIR regulation, ESMA is asked to take into account the specific nature of OTC derivative contracts which are concluded with covered bond issuers or with cover pools for covered bonds in connection with the determination of the classes of derivative contracts to be subjected to the clearing obligation. Consequently, the regulation appears to grant ESMA the mandate to define criteria under which OTC derivative contracts concluded with covered bond issuers or with cover pools for covered bonds may be classified as not eligible for CCP clearing.

This specific issue is, however, not addressed in the present draft delegated regulation. Does this mean that ESMA intends to address this particular question in another context, i.e. when determining the individual classes of derivative contracts subject to the clearing obligation?

Chapter V: Public register

Art. 1 PR para. 4 (Phase-in)

The practical implementation of the clearing obligation will be very challenging. Market participants thus need sufficient time to adjust their processes. The clearing obligation therefore needs to be phased in over a sufficient period of time. The draft proposal allows for such a phase-in, however, it appears to limit the possibility to structure such phase-in solely by categories of counterparties. This will almost certainly be too restrictive. The manner in which a phase-in is to occur should be defined on a case by case basis, allowing a significant degree of flexibility, including the flexibility to structure the phase-in on the basis of other categories than counterparties (i.e. sub-categories of products).

Chapter VII: Non-financial counterparties

Art. 1 & 2 NFC (Clearing thresholds of NFCs)

We would welcome further clearer distinction in Article 1 NFC in form of an additional paragraph that clarifies that it is the sole responsibility of the non-financial counterparties (NFC) to monitor their derivatives positions and inform their counterparties accordingly, if they have breached any of the non-clearing thresholds. As only the NFC can be knowledgeable of all of its positions – a view which is also shared by

ESMA[1] – and in order to create legal certainty of the duties of all counterparties, we would kindly as for further clarification in the RTS.

As a further step in the interest of legal certainty market participants need to be able to rely on publicly available, official information. The current draft delegated regulation should therefore include provisions requiring the registration of the identity of all non-financial entities subject to the clearing obligation in a public register. Ideally this would be the public register maintained by ESMA. Otherwise, counterparties would be forced to rely solely on the statements of their counterparties on their respective status without any means to verify such statements.

Chapter VIII: Risk mitigation for OTC derivative contracts not cleared by a CCP

Art. 1 RM paragraph 2 & 3 (Timely confirmation)

The time required for a confirmation can differ considerably depending on the type of transaction and market participants involved. In particular small and medium sized 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, etc.) for the processing of transactions and thus will generally require more time for processing transactions.

Furthermore, 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).

Lastly, the time limit proposed under Article 1 RM para. 2 appears to be based on benchmarks set by these 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 bespoke transactions). Against this background, a limit of 5 days would be more realistic and ensure higher quality and efficiency of the confirmation process with regard to non-electronic confirmation of less sophisticated market participants. We therefore suggest the following amendment of Article 1 RM para 2 (addition in bold and italic):

> 2. An OTC derivative contract concluded with a financial counterparty or a non-financial counterparty that meets the conditions referred to in Article 10(1)(b) of Regulation (EU) No xxxx/2012 [EMIR] and which is not cleared by a CCP shall be confirmed, where available via electronic means, as soon as possible and at the latest by the end 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.***

[1] Statement by ESMA during the public hearing on 12 July 2012 in Paris

Art. 2 RM para. 4 lit a. & b. (Portfolio reconciliation)

The suggested thresholds for mandatory portfolio reconciliation under Article 2 RM para. 4 are too high with regard to smaller financial counterparties with a limited range of derivative exposure. 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. (additions in bold and italic):

> ***iii. Once per year for a portfolio between 1 and 50 (or X, to be cleared by ESMA) OTC derivative contracts outstanding with a counterparty.***

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.

If ESMA confirms the provisions as set out in Art. 4 RM, we would subsequently suggest the required dispute resolution procedures for OTC derivate contracts to have a certain threshold (i.e. EUR 15 million) that provides enough flexibility. Contracts above this threshold outstanding for at least 15 business days should be promptly reported to the competent authority.

Art. 7 RM (Intragroup notification details)

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 EMIR releases a general exemption whereas subpara. 2 lit. b refers to the cases of cross border transactions within and outside of the EU.

The provisions of Art. 7 RM for the notification procedure should be complemented by a possibility to have a general notification to exempt all intragroup transactions instead of a case-by-case basis.

Article 8 RM lit. d (Intragroup transaction – Information to be publicly disclosed)

Regarding the public disclosure requirement of an intragroup exemption we have spotted a few inconsistencies regarding:

- The information proposed lit. c. should be consistent with intragroup transaction referred on paragraph 6 to 10 of article 11 of EMIR Regulation.
- Under lit. d. the draft asks for "the notional aggregate amount of the OTC derivative contracts for which the intragroup exemption applies" to be published. The Level-1 text of EMIR does not provide a maximum notional exemption for

intra-group transactions. In this particular case the notional aggregate amount of those contracts should be considered as commercially sensitive data that should not be published. It should be enough for the public to know that exemptions exist but the amount of those contracts does add additional value only to authorities.

ANNEX III

Chapter XI: Collateral

Art. 1 COL par. 3 (Types of assets eligible as collateral)

We are of the opinion that government bonds of the country where the client has his registered office should be seen as eligible assets for collateral purposes. In this case the CCP will be able to apply the haircuts it considers appropriate.

Contact

The EACB trusts that its comments will be taken into consideration. Should there be any need for further information any questions on this paper, please contact:

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