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The EBF is committed to supporting EU policies to promote the single market in financial services in general and in banking activities in particular. It advocates free and fair competition in the EU and world markets and supports the banks' efforts to increase their efficiency and competitiveness.

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EBF's response to the European Commission's Public Consultation on Derivatives and Market Infrastructures

Key Points

The EBF very is supportive of central clearing. The process to determine that a clearing obligation exists for any given derivative contract should be triggered by a request from the clearing infrastructure, with the favourable advice of its Risk Committee. The Federation disagrees with the so-called top-down approach. Whilst ESMA conducts the assessment to determine a clearing obligation, EBA and the ESRB should have veto powers over the final decision. ESMA's public register should include contracts subject to mandatory clearing and those for which the assessment has been negative. The application of a clearing obligation to third country firms should be agreed internationally. An exception should be granted to intra-group transactions. The EBF strongly encourages the Commission to assess thoroughly whether supported exemptions from the general clearing obligation for non-financial undertakings on the basis of systemic risk considerations could also be applicable to financial counterparties.

The EBF is supportive of robust governance arrangements for CCPs in view of their potentially systemic relevance to the stability of the financial sector. CCPs shall take the appropriate actions to guarantee the permanent fulfilment of their obligations in order to reduce the source of operational risk for themselves and for their participants. To this end, users (i.e. banks) must be adequately represented in the Risk Committee, as they ultimately bear the default risk of a CCP through contributions to the default fund.

The EBF considers that rules to address potential conflicts of interest should apply to all CCPs, irrelevant to their model, and should not depend on the ownership structure. Also, as CCPs are single-purpose organisations which, by definition, are risk takers, they should not get involved in any non-core business activities. While the default fund should be mandatory, CCPs should resist lowering the initial margin levels in an attempt to compete on risk management. Finally, CCPs could have access to central bank liquidity in exceptional circumstances but not at the expense of lower risk management neither it should lead to moral hazard situations.

The EBF is supportive of interoperability as a general principle. A general right to interoperability may however have unwanted consequences like a market paralysis due to excessive links, many of them becoming useless or inactive. Therefore, it is important to also consider users' demand (in addition to the basic risk evaluation) as a prior requirement for interoperability. As there is serious doubt that interoperability can effectively be introduced in the area of derivatives, this concept must at present be limited to cash instruments.

The EBF is supportive of a regulatory reporting obligation inclusive of all derivatives trades, irrespective of their clearing modality. The regulatory reporting obligation should be constructed in such a way so as to replace any resulting duplicate reporting obligations. If the financial institution is part of the contract, it should be enough with one communication (i.e. the one from the financial entity) to the trade repository. Contracts where no financial institution is involved should be reported by any of the counterparties.

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Related documents:

[EBF's views on the upcoming European Commission's proposal for a Regulation on Market Infrastructures](#)

Preliminary remarks

1. The European Banking Federation (EBF) has recently published a paper¹ where it conveys the views of the European commercial banking community on over-the-counter (OTC) derivatives and their market infrastructures. That paper provides the foundation upon which this response has been prepared.
2. Unless otherwise stated, the EBF's responses to the European Commission's (COM) questions are henceforth presented as those of the users (i.e. banks) of post-trading infrastructures (and associated services).
3. The EBF notes that the COM's proposals would result for banks/clearing members in presumably an increase in the resources that would be committed to central clearing (e.g. contributions to a default fund, initial margin, margin requirements, credit lines, etc.). Transition costs may be substantial (up to about \$150 billion, according to the Bank for International Settlements (BIS) and the International Monetary Fund (IMF) staff estimates²). The EBF understands that the final legislative proposals will be accompanied by a detailed economic analysis. The EBF would welcome that the COM's final policy choice is balanced, also in view of the possible economic consequences for the European banking sector.
4. Although expressly carved out of the consultation as a topic, the EBF favours that the authorisation to operate for CCPs should occur at European level while the supervision of CCPs should remain at domestic level.
5. The EBF would welcome clarity as to how existing central counterparties (CCPs) will be requested to implement the new arrangements and as to whether the new requirements will apply to existing OTC derivatives contracts.

1. Clearing and risk mitigation of OTC derivatives

What are stakeholders' views on the clearing obligation, the process to determine the eligibility of OTC derivative contracts for mandatory clearing, and its application? Do stakeholders agree that access from trading venues to CCPs clearing eligible contracts should be guaranteed?

6. The EBF is very supportive of central clearing of OTC derivatives contracts. The EBF has been actively contributing to some of the early initiatives that the COM has taken to improve financial stability in derivatives markets. In particular, the EBF has supported the establishment of central counterparties (CCPs) in Europe to facilitate the clearing of eligible CDS derivatives contracts and the back loading of the relevant outstanding

¹ <http://www.ebf-fbe.eu/uploads/documents/positions/FinMark/D0602E-2010EBFviewsonupcomingEMIJune%202010.pdf>

² Global Financial Stability Report "Meeting New Challenges to Stability and Building a Safer System" April 2010. See at: <http://www.imf.org/external/pubs/ft/gfsr/2010/01/pdf/chap3.pdf>

contracts³. Dealers' progress on central clearing within the boundaries of what it is possible (i.e. for CCP-eligible contracts) has been recently recognised by the Financial Stability Board⁴

7. However, the Federation notes that it has not been proven that mandatory central clearing - the message arising from the September 2009 G20 meeting⁵ - should be the cornerstone of policy proposals aimed at attaining the regulatory objective of reducing counterparty risk significantly. To achieve that objective, the EBF favours a combination of four measures: (i) market-driven central counterparty clearing (ii) maintenance of capital incentives for central clearing of OTC contracts; (iii) strengthening of collateralisation in bilateral clearing and (iv) proper corporate governance and effective supervision to address counterparty risk issues in OTC derivatives markets.
8. Whilst the Federation acknowledges the COM's concerns over entirely leaving the initiative to the clearing industry in the determination of the scope of the clearing obligation, it should be noted that public-led action presents the following key adverse implications: (1) it could facilitate the consolidation of monopolies if a clearing obligation is imposed for a class of derivatives that is cleared by a single CCP; (2) it could exacerbate risks for a clearing house clearing products for which it does not have the risk management capability to support orderly liquidation; and (3) it could worsen bilateral counterparty exposure by splitting up eligible and ineligible positions that would otherwise provide a counterparty risk offset.
9. With regard to the specifics of the process proposed by the COM to determine the scope of the clearing obligation, the Federation notes that the COM has introduced a distinction between the G20 message and the practical implementation of that message and that, on the basis of that distinction, the scope of the obligation has been clarified (i.e. from the original "all standardised OTC derivatives" to "contracts that a CCP is able to clear"). The Federation welcomes this clarification as it seems to take into account other aspects connected to clearing-eligibility, notably liquidity. Liquidity is most important especially for two reasons: (1) it is needed for mark to market valuations; and (2) in case of default of a participant for unwinding of the position by the CCP.
10. The Federation notes, however, that, in both of the described approaches (so-called *bottom-up* and *top-down*), the process to determine the clearing obligation is triggered in the absence of an explicit request from the CCP. This seems in contradiction with the COM's intention to put a CCP's ability to clear any given contract at the centre of the process to establish the clearing obligation. Furthermore, the Federation notices that the eventual imposition of a clearing obligation over a contract for which there is no central

³ See at:

<http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/77&format=HTML&aged=0&language=EN&guiLanguage=fr>

⁴ See at: http://www.financialstabilityboard.org/publications/r_100419.pdf

⁵ The previous G20 meeting, in April 2009 in London, did not call for mandatory clearing but instead for "the promotion of the standardisation and resilience of credit derivatives markets, in particular through the establishment of central clearing counterparties subject to effective regulation and supervision". See at: www.londonsummit.gov.uk/resources/en/PDF/annex-strengthening-fin-sysm

clearing facility, as in the described top-down approach, would leave the status of contracts in that class in limbo (as they cannot be cleared).

11. The imposition of a clearing obligation upon market participants would result in a number of consequences:

- CCPs and their members would be exposed to undesired businesses and clients. If CCPs are unable to turn away “eligible” trades, they will be required to charge higher amount of initial margin and result in large unidirectional positions. The result is increased risk to the CCP.
- Due to the need to limit risks, a CCP (which might be the only one clearing a certain class of eligible derivatives) could impose certain limitations on the transactions of its members, leading to a potential disruption of the whole system, thus restricting the ability for businesses to hedge risks.
- Forcing a CCP-eligible contract into CCP clearing could unbalance the counterparty risk profile of a market participants' portfolio with a particularly counterparty with whom other non-clearable transactions are also outstanding. Such a transfer could also increase the risk-profile vis-à-vis the CCP.
- In a context where ESMA decision's may lead to the channelling of additional clearing volumes onto CCPs - thus turning those infrastructures into systemically relevant pieces in the securities post trading space - national competent authorities could be tempted to move away from their obligation to support their respective CCPs by requiring unnecessary and excessive margins and funds, thus imposing increased operational costs for EU-based financial entities.

12. Furthermore, the EBF notes that there may be circumstances where it may not be prudentially advisable to clear (additional amounts of) eligible OTC contracts centrally, for example, when a CCP fails to have sufficient capacity to provide high level clearing services and/or to appropriately manage risk exposures. As a result, no clearing obligation should be imposed upon OTC derivatives contracts counterparties without confirmation that there is at least a market infrastructure with a proven record of being able to assume the counterparty risk of a range of trading parties and of ensuring efficient and adequate collateralisation of the exposure in a way that it fully understands.

13. The Federation considers that the future European Banking Regulator (EBA) should be associated to the process to determine the clearing obligation beyond the public consultation process foreseen for all stakeholders. The role of EBA in assessing possible counterparty risks and the impact of the imposition of the new obligation over bank's capital requirements should grant EBA a veto over the process. Likewise, the European Systemic Risk Board (ESRB) has a role in determining whether the imposition of a clearing obligation may lead to the overall reduction of systemic risk, notably taking into account the additional strain that may be put on the clearing infrastructure as a result of that decision. The ESRB should, therefore, also have a veto over the decision to impose a clearing obligation.

14. The Federation is supportive of a process to determine what OTC contracts should be subject to a central clearing obligation that is in compliance with the following six principles:

- i. ESMA can only determine that a clearing obligation exists for any given derivative contract if a request to establish such determination comes from a CCP clearing such a contract. ESMA should not have the authority to establish a clearing obligation on a contract if there is no connected request from a CCP.
- ii. Any request from the CCP to ESMA to determine that a clearing obligation exists for any given derivative contract, should have been favourably advised by the CCP's Risk Committee.
- iii. The assessment by ESMA of whether a clearing obligation exists for any given derivative contract should be taken on the basis of strict, public, and objective criteria. The set of assessment criteria will be subject to public consultation before being approved. The set will contain - at least - a criterion related to the reduction of systemic risk that mandatory clearing of any given contract would achieve; and another one looking at whether a similar obligation has been imposed in other relevant jurisdictions, so as to ensure global coordination.
- iv. ESMA's assessment to determine a clearing obligation for a specific contract should itself be subject to public consultation. Given the interest to calibrate the appropriate measures in accordance with the industry and end-users expectations, the 6 month period envisaged by ESMA to arrive at a decision should begin once all the responses to the public consultation have been received. ESMA can only produce a positive assessment in the absence of possible vetoes from EBA or the ESRB.
- v. It should be avoided that the process to determine an obligation to clear eventually incentivises competition among CCPs on risk management grounds. For that reason, when the assessment process described above is negative or a veto exists, ESMA should list the instrument as one where no obligation to clear it centrally exists (i.e. negative list). Additionally, ESMA should allow for a de-listing of products upon which a clearing obligation has been established should the reasons that resulted in a positive assessment cease to exist.
- vi. The application of a clearing obligation to third country firms should be agreed internationally. An exception should be granted to intra-group transactions and thus also to transactions which only serve the purpose to transfer risks within a group (within the meaning of the directive 2000/12/EC - Banking Directive - and thus subject to supervision on a consolidated basis) to the other group entities in order to allow a more efficient risk management (which as purely internal transactions do not increase the overall risk exposure of the relevant banking group and thus have no impact on the systemic risk)⁶.

⁶ A clearing obligation for such transactions would greatly diminish the efficiency of the risk management of a group. It should thus be considered to expressly clarify that intra group transactions (in case of banking groups subject to supervision
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15. Once a contract is deemed eligible for mandatory central clearing, market participants need sufficient time to sign up with an authorised CCP, modify their communication infrastructure and make the necessary system changes before being able to comply with the obligation. Considering that a confirmation from ESMA on a specific contract could result in simultaneous inquiries from a substantial number of market participants to the clearing CCP, there should be a grace period of at least one year from the confirmation where bilateral clearing of that contract would still be allowed. The EBF would furthermore encourage the COM to keep in mind that if a large number of contracts are deemed eligible for mandatory CCP-clearing within a short period of time e.g. shortly after the enactment of European regulation in this area, it would be appropriate to extend the grace period in order to give market participants opportunity to make the required arrangements with multiple CCPs. Depending on the final decision over grandfathering / phasing-in arrangements, such a grace period would also be necessary to enable clearing firms to handle closing out existing positions without having to place such close out trades into clearing.
16. The EBF has a difficulty with the term “class of derivatives”. According to the proposal, the obligation to clear via a CCP will exist in relation to a “class of derivatives”. This term is defined in the Glossary of Definitions. However, this definition is very general and thus ambiguous. More importantly, the definition does not appear to take into account that the term plays an important role in at least three very different circumstances: in the context of (1) the regulatory permission (authorisation) of a CCP to clear (item I 2 lit a); (2) the eligibility for CCP clearing (item I 2 lit. b); and (3) in the context of the threshold for non-financial entities on the other (item I 4 lit. b). Each context demands an - enforcedly different - understanding of the term adjusted to the specific objectives. The term thus cannot be interpreted uniformly in all three circumstances⁷. At the very least, the differences will have to be addressed in the relevant concrete rules and criteria to be developed. In that context, it should be noted that banks (the “so-called” G14) and supervisors have already defined some “standardised contract types” that serve as basis for target settings / portfolio reconciliation minimum market standards / metrics / and trade repositories.
17. The EBF considers that market participants meeting appropriate admission criteria and/or any other specific obligations should be given open access (i.e. non discriminatory) to CCPs. Furthermore, CCPs should not discriminate against firms in determining what contracts it will clear. In order to ensure that open and fair access is permitted, a CCP's participation requirements should be publicly disclosed. Such fair and open access should apply internationally to third country customers, clearing members and CCPs, thereby enabling international trade. The EBF considers it imperative that international regulatory should work together to remove/prevent any national barriers to such an objective.

on a consolidated basis and under the condition that all these transactions are integrated into the groups risk management system) would not fall within the ambit of the clearing obligation.

⁷ For example, whereas the underlying to a derivative will be of relevance in the context of eligibility for CCP clearing and thus could be an important criteria for defining a class of derivatives eligible for clearing (e.g. for some underlyings or type of underlyings, the liquidity may be too limited to allow CCP clearing), this does not hold true in relation to the net position by counterparty per class of derivatives as a factor for defining thresholds.

18. In connection to the question on whether “*access from trading venues to CCPs clearing eligible contracts should be guaranteed*”, the Federation would like to note that access to CCPs is afforded to OTC derivatives contracts counterparties (i.e. CCP members or their clients) and not to market infrastructures. The question is, therefore, confusing. If the issue is whether a CCP that has been authorised to clear eligible derivative contracts is “obliged” (i.e. a legal obligation to clear those derivatives contracts has been legally construed) to accept clearing of such contracts on a non-discriminatory basis, the response is “yes”, and this for a number of reasons, notably:

- Giving the CCPs the option not to clear those contracts would put the counterparties to the contracts in a non-compliant situation.
- Counterparties to the contract could be penalised - from a capital requirements perspective - by the CCP's refusal to abide by a legal obligation.

Do stakeholders share the general approach set out above on the application of the clearing obligation to non-financial counterparties that meet certain thresholds?

19. The EBF agrees with the COM that monitoring the extent to which an institution's default could harm other derivatives' users and the financial system overall, is the yardstick by which the appropriate management of that institution's exposures should be determined. The Federation agrees with the COM that such approach could be implemented by means of a system of thresholds (one of them, a clearing threshold). The clearing threshold should be set at such a level as to ensure that non-financial counterparties are not unduly burdened with a requirement to clear contracts through a CCP, while ensuring that only end-users that pose a significant risk reach the thresholds and, in turn, are subject to mandatory CCP-clearing of the relevant contracts. The EBF would like to stress that financial counterparties do not have the sufficient information to monitor to what extent non-financial counterparties use OTC-derivatives. As such, the responsibility of applying any threshold either in regard to information or clearing should rest solely with the non-financial counterparty.

20. Furthermore, the Federation considers that the threshold system could be applicable to financial and non-financial counterparties alike. On the basis of the same rationales envisaged for non-financial counterparties, an exception could be granted to financial counterparties that take positions below what can be considered as systemically relevant, looking at the sum of its nets positions. Such an exception would permit that smaller financial counterparties are not subject to mandatory central clearing (irrespective of whether they decide to go to CCPs, in view of existing capital relief incentives) thus making the regulation proportional to the actual risks of the counterparties. The Federation considers that this kind of legislative approach would be balanced and proportional to the actual risk of the counterparties. The Federation therefore suggests the Commission to assess deeply the merits of this proposal. In addition the Federation highlights the importance of the *correctly targeted legislative measures* whereby the goals are able to be achieved without jeopardizing the functioning of the financial market.

21. In addition, as stated above, the Federation invites the COM to consider an exception to intra-group trades (i.e. transactions entered between two financial counterparties which

belong to the same corporate group or other similar consolidating structure.). Failure to do could lead to increased cost for banks as they would have to margin both sides.

22. Finally, some clarity as to how to calculate the thresholds proposed would be very much welcomed⁸.

Do stakeholders share the principle and requirements set out above on the risk mitigation techniques for bilateral OTC derivative contracts?

23. The Federation agrees with the COM that the widespread use of central clearing needs to be complemented by existing counterparty credit risk reduction tools for contracts that cannot prudently be centrally cleared, specifically: close-out netting and the collateralisation of derivative contracts. Also, the traditional forms of physical collateral between a financial institution and an end-user corporation e.g. plants and machines, should be acknowledged as effective credit risk mitigants. The COM is encouraged to determine the applicability of those requirements on a product by product basis.

24. In this context, the Federation wonders up to what extent, non financial counterparties are expected to be brought under any kind of financial (micro) or systemic risk (macro) supervisory framework.

25. In addition, the EBF would like to note that when the value of outstanding contracts is calculated, it should be measured on a mark-to-market basis as a general rule. However, in the case of non-vanilla contracts, a reliable "mark-to-model" should be sufficient if true mark-to-market valuation is not available.

26. With regard to operational risk, electronic means ensuring the effective confirmation of the terms of the contract should be in place only to the extent that the product is standardized and that volumes are significant.

2. Requirements for central counterparties

Do stakeholders share the general approach set out above on organisational requirements for CCPs? In particular comments are sought on the role and function of the Risk Committee; whether the governance arrangements and the specific requirements are sufficient to prevent and manage potential conflicts of interest; stringent outsourcing requirements; and participation and transparency requirements?

27. The EBF welcomes the harmonisation of rules regulating CCPs across the EU and agrees with the general approach on organisational requirements as laid down in the document open for public consultation. However, the Federation would like to make some comments on specific aspects of the governance architecture and principles.

⁸ This calculation could be done in many ways, for example, by: (a) nominal amounts; (b) evaluating the risks of the transaction and the counterparty's financial state; (c) assessing the purpose of the transaction i.e. is it a speculative transaction or hedged intended transaction, and (d) the number of different counterparties for OTC derivatives (and possibly separated between the number of end-user counterparties and the number of financial counterparties).

28. The EBF recalls that the primary aim of the Risk Committee is to be closely involved in all decisions affecting the risk associated to the activities of a CCP. To this end, the Federation stresses that the users (i.e. banks) have to be adequately represented in the Risk Committee, with appropriate voting rights, as they are those who take part in the mutualisation process and ultimately bear the default risk of a CCP through contributions to the default fund. The close involvement of clearing members is therefore essential for the CCP to decide whether to clear any (derivatives) contract and to properly manage the possible default of one or several clearing members. The EBF reminds that one lesson from the financial crisis is that the separation of decision-making and risk-bearing can be a source of problems.
29. While the Federation understands the need to ensure the Risk Committee is objective, we question the inclusion of independent administrators who are not financially committed in the same manner as the clearing members of a CCP. The mutualisation of risk is a key function of the CCP and representation on the Risk Committee without participation in the default fund could lead the CCP to look at commercial aspects rather than to focus on risk management when accepting new products or members.
30. The EBF is in the opinion that any decision by a CCP which would not follow the advice of the Risk Committee should be exceptional and would need to be duly documented and explained to both the competent authority and the users.
31. As regard outsourcing, the EBF shares the views of the COM in the sense that the critical and core functions of a CCP (clearing, risk management, etc.) must not be outsourced. Outsourcing between a CCP and a service provider belonging to the same group could, nevertheless, be allowed as long as it fulfils strict conditions, as laid down in the provisions of the forthcoming legislation, and does not result in a delegation of responsibilities by the CCP. Should a CCP decide to offshore some of its functions without outsourcing them, ESMA would first have to give its approval and the users would have to be informed beforehand. Without the fulfilment of these conditions, the Federation will oppose such a move. Special attention should also be paid to prevent disclosing confidential information in case of outsourcing or offshoring.
32. The EBF agrees with the COM that the criteria to access a CCP should be non-discriminatory, transparent and objective. However, the Federation, in principle, opposes the idea that a clearing member of a CCP should disclose to the CCP the contractual arrangements that the clearing member has agreed on with its clients to access the services of the CCP. The EBF considers that this information is proprietary and should therefore not be disclosed to a third party. If a clearing member meets the membership criteria, then it is that clearing member's responsibility to take on the risk of its clients. In addition, the EBF questions the definition of and the ability to determine the proportionality to risk
33. The EBF agrees that a CCP should publicly disclose information on fees and prices associated with its services, so as to ensure greater transparency, better comparability (through price simulation tools e.g.), non discrimination and genuine choice for users when identifying and evaluating the risks and costs associated with using the services of a CCP. The Federation recognises that risk management models and assumptions are proprietary information that should primarily be disclosed to regulators but also, if

requested, to direct participants and participants applying for membership, in order for them to replicate the risk model in their own calculation of risk exposure vis-à-vis their clients.

Do stakeholders consider that possible conflicts of interests would justify specific rules on the ownership of CCPs? If so, which kind of rules?

34. No, the EBF is convinced that the proposed measures are entirely sufficient. As a general principle, the Federation is of the opinion that CCPs' ownership should not be an obstacle for the development of a competitive post-trading environment. No general restrictions should apply as to the identity and holdings of possible CCPs' shareholders. Specific requirements (e.g. suitability, influence) or procedures (e.g. notifications, consultations) may, however, apply at the time of the authorisation or when the acquirer(s) reaches certain voting thresholds.
35. In this respect, the EBF stresses that users-owned CCPs do not bear more risk than other models (e.g. 'for-profit' CCPs). In a users-owned model, users' capital is at risk both as a clearing member and as a shareholder. So, CCPs under user ownership should have a stronger and reciprocal incentive to monitor and control risks incurred by its members due to the mutualisation of losses through loss-sharing rules. In contrast, 'for-profit' CCPs may more easily give rise to a natural conflict of interest as their incentive is not necessarily good risk management, but rather maximising profits. Therefore, as it is rather difficult to identify the optimal ownership model of a CCP, the Federation is of the opinion that conflicts of interest should be addressed in the same manner, along the same principles and requirements, for all CCPs, irrelevant to their model.

Do stakeholders share the approach set out above on segregation and portability?

36. The EBF first believes that segregation and portability should be limited to OTC derivatives and not extended to cash instruments, given the high number of trades that would then be concerned. Such an inclusion would indeed reduce the netting effect associated to central clearing (transactions would be registered on a gross basis) and drastically increase the complexity of the settlement processes (including back-office operations), thus encouraging risks of fails (non-delivery of securities).
37. In the opinion of the EBF, the requirements regarding segregation should not be mandatory but remain a commercial offer. These requirements should also remain flexible enough so as to take into consideration the variety of clearing models with different levels of segregation CCPs should be able to offer to suit the needs and requirements of different clients. Effective segregation between the assets of a clearing member and the assets of the clients of this clearing member, and also between the distinct clients, is, of course, essential. However, a CCP should have a certain degree of discretion over further additional levels of segregation as these may pose – depending on the extent of fragmentation – considerable organisational challenges. Thus, the Federation believes that a CCP should be able to impose certain restrictions and limitations where further segregation is not feasible (i.e. the second sentence in lit. b) is somewhat ambiguous in this respect but may be read as to give clients a right to demand further levels of segregation).

38. As regards the transfer of segregated positions, the EBF believes that the ability of a CCP to execute the transfer of client's positions in the event of a default of the relevant clearing member will be an essential instrument to mitigate risks for clients. Legal certainty over the effectiveness of such transfer is, therefore, of paramount importance. Specifically, it should be ensured that such transfer is valid and enforceable and cannot be prevented by applicable national insolvency laws. The Federation recalls that insolvency laws within the EU have not yet been fully harmonised in this respect. Consequently, to ensure the requisite legal certainty, it will be necessary to achieve such full harmonisation. Due to the importance of this aspect, the EBF believes that the European legislation must ensure that the objectives of segregation and portability cannot be impaired by national laws.
39. The EBF concurs with the idea that clients should be able to benefit from any reduced counterparty risk exposure of a CCP when they are not exposed to the default risk of the relevant clearing member. Such an assessment cannot be made by the individual clients or clearing members but must come from a regulatory authority. In this respect, the Federation believes that it should be necessary to grant the competent regulatory authorities the power to make such official confirmation following a positive assessment (or a declaration that the assessment was negative, as the case may be).

Do stakeholders share the general approach set out above on prudential requirements for CCPs? In particular: what should be the adequate level of initial capital? Are exposures of CCPs appropriately measured and managed? Should the default fund be mandatory and what risks should it cover? Should the rank of the different lines of defence of a CCP be specified? Will the collateral requirements and investment policy ensure that CCPs will not be exposed to external risks? Will the provisions ensure the correct management of a default situation? Are the provisions above sufficient to ensure access to central bank liquidity without compromising central banks' independence?

40. The EBF agrees with the COM on the need for harmonised prudential requirements for CCPs in view of their potentially systemic relevance to the stability of the financial sector. The Federation has always stressed that CCPs must have robust governance arrangements in place and ensure they operate on a sound and safe basis. As banks have an interest in understanding how a CCP is organised and in resting assured about the sustainability of the CCPs' high standards, those arrangements, together with the obligations and requirements that are imposed on CCPs, should be disclosed to participants and potential participants. The Federation would nevertheless like to make some comments on the key prudential requirements and risk management elements.
41. The EBF stresses that CCPs are single-purpose organisations which, by definition, are risk takers. Therefore, the Federation believes that CCPs should concentrate on their core business (clearing, risk management) and should not get involved in any non-core business activities. To this end, CCPs must have capital capable of preserving their stability. The EBF is not in a position to assess what should be the adequate level of initial capital but insists that this capital level should be risk-sensitive.
42. The EBF agrees with the provisions laid down to measure and manage the exposures of CCPs. While the models and parameters adopted by a CCP in setting its margin

requirements should be validated by the competent authority, they should also be automatically disclosed to the clearing members of the CCP and to any potential clearing member upon request.

43. In the opinion of the EBF, the default fund should be mandatory. The Federation invites, however, the COM to clarify the distinction between the default fund and the other risk controls as they seem to be mixed up in the proposed text.
44. As the potential size of the default fund depends in principle on the initial margin levels a CCP charges on cleared products, the EBF is concerned that CCPs may lower those initial margin levels (to resist competitive pressure for instance) to the detriment of the clearing members who would then need to contribute to a larger default fund to cover the difference. In addition, the Federation highlights that the default fund should only be used once in the context of a default.
45. The EBF is in principle supportive of one default fund per asset class and encourages CCPs, in close cooperation with its clearing members, to conduct a cost-benefit analysis to assess what are the opportunities to achieve this goal.
46. The EBF agrees with the default waterfall procedure described in the public consultation paper but invites the COM to explicitly and clearly state the rank of the different lines of defence of a CCP, especially as lit. c) may bring some confusion on the use of the initial capital of a CCP in the default waterfall. In the opinion of the Federation, the rank should be as follows: 1) margins of the defaulting clearing member; 2) default fund contribution of the defaulting member; 3) CCP's own funds; 4) default fund and other contributions of the non-defaulting clearing members. In this respect, the Federation stresses that the default fund contribution of the defaulting clearing member should be used in its entirety before moving to the default funds and other contributions of non-defaulting clearing members. For the rest, CCPs should be left with some flexibility for drawing up the details of the different lines of defence.
47. In view of the differences between jurisdictions across the EU, the EBF believes that the criteria to define the eligible collateral have to be broad enough so that they do not inadvertently exclude eligible forms of collateral for terminological reasons or because a certain form of collateral generally accepted in a national market and sufficiently liquid is alien in another markets. In this respect, financial assets that are eligible under the Financial Collateral Comprehensive Method (Part 1.3 of Annex VIII to the Banking Directive) should, in principle, be considered.
48. In addition, the EBF believes that minimum thresholds and requirements should be specified. However, the Federation worries that if a CCP should only accept highly liquid collateral, this could create new risk if there is not enough such highly liquid collateral in the system. The Federation would also suggest that investment policies be subject to regular audit by the supervising authorities.
49. Furthermore, in order for CCPs to guarantee the permanent fulfilment of their obligations, so as to reduce the sources of operational risks for them but also for their participants in case of a default situation, the Federation is supportive of granting CCPs access to central

bank liquidity in exceptional circumstances. Such an access should indeed not be at the expense of lower risk management and should not lead to moral hazard situations. In addition, the EBF calls for Continuous Linked Settlement (CLS) to be included as a mean of settlement in addition to central banks.

50. Finally, the Federation invites the COM to reflect on the consequences arising from the eventual decision to mandate the use of CCPs and whether and how that mandate should relate to the financial responsibility of those authorities sanctioning their use (see also item 11 bullet point 4).

Do stakeholders share the general approach set out above on the recognition of third country CCPs? Are the suggested criteria sufficient? Do stakeholders consider that additional criteria should be considered?

Do stakeholders agree with the extension of the clearing obligation to contracts cleared by third country CCPs to ensure global consistency?

51. The Federation agrees with the principle of allowing third-country based CCPs to provide clearing services to entities established in the EU subject to the set of criteria identified by the COM. These criteria should be seen as cumulative.
52. The Federation recommends that a reference to the role of new European Supervisory Authorities (ESAs) assisting in preparing equivalence decisions pertaining to supervisory regimes in third countries is included.
53. The EBF is not in favour of unilaterally extending EU-decided clearing obligations to contracts cleared by third country CCPs. Alternatively, the EBF considers that enhanced, ex ante coordination is paramount to ensure that no different clearing obligations are imposed upon OTC derivatives market participants. A possible solution would be to ensure that existence of an international consensus over the eligibility of a class of instruments for central clearing is a “do-or-break” parameter among those that ESMA will use to establish a central clearing obligation.
54. International arrangements could also cover issues such as (equal) access by EU firms to the third country's CCPs, clearing members and customers.

3. Interoperability

Stakeholders' views are welcomed on the general approach set out above on interoperability and the principles and requirements on managing risks and approval.

55. Although the EBF supports the concept of interoperability as a general principle, the Federation expresses serious doubt that this concept can effectively be introduced in the area of derivatives. Rather, the EBF is convinced that interoperability would necessarily result in complexity and might lead to unsupportable or unmanageable risks for the CCPs and ultimately their users. Therefore, the EBF shares the view of the COM that the right to enter into an interoperability arrangement must at present be limited to cash instruments only.

56. The EBF welcomes the principle, which hopefully respond to regulators' concerns, to restrict the right of interoperability between CCPs in case a potential risk may arise from an interoperability arrangement. However, the Federation is concerned about the unwanted consequences a general right of interoperability might have. Excessive links (the 'spaghetti' model), with many of them becoming effectively useless or inactive, could indeed lead to a market paralysis, thus increasing the level of systemic risk and having unnecessary costs for users while these costs could be better used to post margin and contribute to the default fund CCPs will set up to cover losses arising from the default of a clearing member.
57. In this respect, the EBF believes it is important to also consider the consultation of users as a requirement for interoperability, i.e. a CCP should demonstrate significant user or customer demand before being allowed to enter into an interoperability arrangement with another CCP. Indeed, while users have to bear the costs of interoperability, in some cases these costs could offset the benefits they would drive from interoperability. Therefore, the Federation asks for the involvement of users in the design of the interoperability arrangement before its approval by regulators.
58. Finally, the EBF agrees with the COM that an effective approval regime by all the relevant authorities must be set up beforehand in order to give effect to an interoperability agreement on the basis of a risk assessment that could arise from such an arrangement.

4. Reporting obligation and requirements for trade repositories

What are stakeholders' preferred options on the reporting obligation and on how to ensure regulators' access to information with trade repositories? Please explain.

59. The EBF welcomes that the COM has changed its initial approach in connection to the scope of the reporting obligation (i.e. from restricting the reports to trades cleared outside of a CCP to including derivatives trades, irrespective of their clearing modality). However, the EBF would like to emphasise that a regulatory reporting obligation to a trade repository should be constructed in such a way so as to replace any resulting duplicate reporting obligations, thereby eliminating redundant reporting by the contracting parties. Additionally, the EBF consider that public transparency is a matter for separate consideration and needs to be carefully assessed in the context of the impact it may have on market liquidity.
60. The EBF is in favour of imposing reporting obligations upon all OTC derivatives markets participants to regulators, irrespective of whether counterparties to the contract or the underlying entity are based in the EU. This rules Option B out. However, the Federation does not agree with the duty to report a trade "on behalf" of a non-financial counterparty, as foreseen in Option A: if the financial entity is part of the contract, it should be enough with one communication (the one from the financial entity), and if there is no financial entity in the contract, such contract would be impossible for any financial entity to report.
61. As a consequence, the Federation would suggest a reporting obligation that mixes elements of A and B and is, therefore, built along the following lines:

- Any derivative contract will be reported.
- If the financial institution is part of the contract, it should be enough with one communication (i.e. the one from the financial entity).
- Contracts where no financial institution is involved should be reported by any of the counterparties.

62. The reporting should be done following the mutual confirmation of both parties. As per the reporting delay, the Federation recommends that the COM defines over time the frequency needed: a system based on “*next day*” reporting may prove onerous to achieve, as most TRs are still works in progress. Furthermore the EBF would ask for clarification from the COM over what is meant by the “value” of the contract. The Federation notes that trade repositories currently receive data containing notional amounts without any mark-to-market elements.

63. The Federation considers that the decision on the establishment of a trade repository should be market-led. Consequently, as trade repositories outside the EU may be used by EU entities, a system of recognition of these market infrastructures needs to be established. The Federation agrees that such a system could be mirrored on that envisaged for CCPs.

64. Trade Repositories must ensure unlimited, continuous and timely access to regulators and supervisory authorities for the performance of their respective functions. Trading repository's authorisation (or recognition) should be on condition that such access is assured.

Do stakeholders share the general approach set out above on the requirements for trade repositories? In particular, are the specific requirements on operational reliability, safeguarding and recording and transparency and data availability sufficient to ensure the adequate function of trade repositories and the adequate protection of the data recorded?

65. The Federation considers that the COM's envisaged operational requirements for Trade Repositories are adequate.

66. The Federation notes that Trade Repositories must ensure accuracy and integrity of the information recorded in their systems. Formats for reporting information to trade repositories should be subject to market-driven, regulatory-promoted standardisation, notably taking stock of the trade characteristics currently reported to existing trade repositories. It should be noted that a way around jurisdictional confidentiality requirements limiting the information that can be reported to TRs may need to be explored in order to ensure that all counterparties are able to report all necessary information.

5. Technical reference glossary of definitions

Do stakeholders agree with the definitions set out above?

The EBF largely agree with the definitions, subject to the following remarks:

- Class of derivatives: See comments on item 17 above regarding the need to distinguish between the application of the term in the context of eligibility and the threshold for non-financial counterparties.
- Financial counterparty/ non-financial counterparty: The clearing obligation will relate to financial counterparties and non-financial counterparties. In the context of the thresholds, financial counterparties are defined by way of reference to MiFID. However, it should be noted that MiFID has not been implemented consistently in all member states, for example, with regard to state entities, some of them active in derivatives markets. Furthermore, the extension of the clearing obligation to certain products may subject entities previously exempted from MiFID to the obligations thereunder as the CCP clearing of derivatives (or the process of margining) may qualify these instruments as financial instruments within the meaning of MiFID.
- Albeit not specifically included in this consultation paper, the Federation notes that definition of "FX Derivatives" in previous COM background documents and in the US context appears not to be aligned. Whilst for the COM, FX forward and swap are included in the definition, in the US those products are not.