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The voice of banking
& financial services

Friday, 9th July 2010

JOINT ISDA, AFME AND BBA RESPONSE TO THE EUROPEAN COMMISSION'S PUBLIC CONSULTATION ON DERIVATIVES AND MARKET INFRASTRUCTURE

Dear Sirs,

Please find attached our response to this consultation. We are grateful for the opportunity to comment on this important matter, and would welcome further dialogue, as appropriate.

Yours sincerely,

Richard Metcalfe, Head of Policy, ISDA

Cassandra Kenny, Director, British Bankers' Association

Christian Krohn, Director, AFME / post trade
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ISDA AFME BBA

ISDA (www.isda.org), which represents participants in the privately negotiated derivatives industry, is among the world's largest global financial trade associations as measured by number of member firms. ISDA was chartered in 1985, and today has over 820 member institutions from 57 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities.

Since its inception, ISDA has pioneered efforts to identify and reduce risk in the derivatives and risk management business. Among its most notable accomplishments are: developing the ISDA Master Agreement; publishing a wide range of related documentation materials and instruments covering a variety of transaction types; producing legal opinions on the enforceability of netting and collateral arrangements; securing recognition of the risk-reducing effects of netting in determining capital requirements; promoting sound risk management practices, and advancing the understanding and treatment of derivatives and risk management from public policy and regulatory capital perspectives.

The **British Bankers' Association** is the leading association for UK banking and financial services sector, speaking for 220 banking members from 60 countries on a full range of UK and international banking issues. All the major banking institutions in the UK are members of the Association as are the large international EU banks, the US banks operating in the UK, as well as financial entities from around the world. The integrated nature of banking means that our members engage in activities ranging widely across the financial spectrum encompassing services and products as diverse as primary and secondary securities trading, insurance, investment bank and wealth management as well as conventional forms of banking.

The Association for Financial Markets in Europe (**AFME**) promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants. AFME was formed on November 1st 2009 following the merger of LIBA (the London Investment Banking Association) and the European operation of SIFMA (the Securities Industry and Financial Markets Association). AFME represents a broad array of European and global participants in the wholesale financial markets, and its 197 members comprise all pan_EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European, and UK capital markets. AFME is the European regional member of the Global Financial Markets Association (GFMA). For more information, visit the AFME website, www.AFME.eu.

AFME/post trade is the European post-trading centre of competence of the Association for Financial Markets in Europe (AFME). Its members are the major users of international securities markets. Representing its members as towards market infrastructure organisations and public authorities, AFME post trade acts as an agent for change providing and supporting solutions in the securities clearing, settlement and custody space to reduce risks and costs to market participants.

Introduction

ISDA, AFME, and the BBA are pleased to respond to the European Commission's "Public consultation on Derivatives and Market Infrastructures". We believe that it is appropriate that there be an EU-level initiative on these infrastructure developments. A consistent European approach is welcome in its own right, as well as in the context of global convergence of legislative and regulatory approaches at the G20 level.

The role of clearing in OTC derivatives has been developing rapidly, having been initially applied to interest rate swaps in the late 1990s; and subsequently to credit derivatives (CDS), as that market grew sufficiently large to support it. In such large, liquid markets, CCPs offer an alternative way of managing 'interconnectedness' by means of risk mutualisation; and incremental efficiencies in exposure reduction through multilateral rather than bilateral netting.

In this context, we believe that the paper could helpfully emphasise certain points more, though we accept that it may stop short of detailed prescription, since the exact standards applicable to a CCP will depend on the product(s) cleared, the counterparties faced and the structure it adopts. Some key points are set out below, followed by some more detailed issues, particularly as regards financial resources.

The industry understands and fully supports the importance of properly-managed trade repositories (TRs) in providing supervisors with trade data, including client names, to enable them to develop a more complete view of OTC derivatives market activity and thereby enhance their ability to oversee the market and its participants. This matters in assessing the distribution of counterparty and market exposure across participants, aiding the timely detection of concentrated positions by any one participant or 'crowded' positions in any one type of trade.

We view TRs as supporting a global market and agree that their operations should be structured to support a global supervisory community that is as co-ordinated internationally as possible. We believe that the role of TRs in systemic oversight make it essential not only that they are operationally robust but equally that there is no fragmentation of this function, since that would defeat the whole object of ensuring efficient aggregation of information by asset class. Fragmentation would also impose unnecessary cost and operational complexity and risk.

One overarching point is that we believe it is vital that there be maximum transparency from CCPs regarding the specific arrangements that each has in place relating to such matters as acceptance of products for clearing; membership criteria; margining; closing out the positions of a defaulted CM; default-fund arrangements, and so on.

We believe that the wider context is important too, as acknowledged in the reference in the paper to proportionate treatment of products that are not cleared. We believe that this could take account of the robust arrangements that are in place for bilateral clearing.

We also note that the paper addresses the issue of passporting, but not the issues surrounding interaction with non-EU CCPs or any potentially conflicting mandates to clear a particular derivative in multiple jurisdictions. We would appreciate clarity as to whether clearing a particular contract through a non-EU CCP could satisfy the mandate to clear within the EU.

We would also note that the events of the last quarter of 2008 provide a rare opportunity to formally examine the administration of CCPs generally under a stressed situation. This may be of use in any more detailed policy-making which we assume will follow the enactment of this measure.

We commend the efforts of the Commission to fully consult on the proposals being considered and look forward to future collaborations and engagement with the Commission during the legislative process.

For the purposes of our response, we assume (unless specified otherwise) that the proposals of section II (Requirements for Central Counterparties) apply to all CCPs, irrespective of the products cleared. We also assume that all the proposals of Section III (Interoperability) apply exclusively to CCPs clearing cash instruments. However we wish to clarify that, unless otherwise stated, our observations below relate only to derivative CCPs.

We attach for ease of reference links[1] to the ISDA responses to the May 2010 CPSS-IOSCO Consultations on standards for derivatives CCPs and TRs. These focus on many details which we believe are relevant to a meaningful discussion of CCPs or TRs; including the issues of data confidentiality – particularly confidentiality of proprietary and customer data – which industry is working to overcome in relation to trade repositories.

[1] www.isda.org/uploadfiles/_docs/ISDAResponseTRs100625.doc
www.isda.org/uploadfiles/_docs/ISDAResponseCCPs100625.doc

Section I (Clearing and Risk Mitigation of OTC Derivatives), Sub-sections 1 (Clearing Obligation); 2 (Eligibility for Clearing Obligation); and 3 (Access to a CCP):

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?

(a) Mandatory Clearing

As an overarching point, we welcome a regulatory regime which looks to maximise the use of central clearing but while ensuring a reduction in systemic risk. That being said, however, we believe that it will always be desirable to exclude some contracts from any mandatory regime. Specific examples include:-

1) Banks are required to manage risk within banking groups – not least as part of resolution planning – and generally do this through derivatives entered into within groups. It could be damaging to this process to subject intra-group derivatives to a clearing requirement. The same argument applies to non-bank groups.

2) Even in the presence of high requirements to clear eligible products it is likely that there will remain significant bilateral counterparty exposures from non-clearing eligible products or from exposures arising from other asset classes. The widespread use of cross-product CSA's helps address this issue and further documentation standardization will help further. Further substantial bilateral risk reduction may be achieved by allowing some. clearing-eligible swaps to remain under bilateral arrangements.

A simple example of this would be the trading of European swap options. These products are important for asset-liability managements but no clearing system currently clears the product. A large component of the risk of a swaption is simple interest rate risk that is hedged using vanilla interest rate swaps. It would be preferable to allow these hedges to remain in the bi-lateral relationship, thereby reducing the risk in that arrangement; rather than forcing the hedge to be cleared, which would give rise to an *increase* in counterparty risk to both the bi-lateral counterparty and the CCP.

3) It is not invariably the case that because a CCP can clear a particular contract it can always in all circumstances clear all of the contracts of that type. If a CCP member's positions are too directional, then the CCP requires larger amounts of initial margin each time the clearing member clears a trade. As the size of the portfolio grows, so does the risk to the CCP. CCPs may therefore find themselves in a position where they may wish to cease clearing a contract which is of a type which has been deemed clearable in order to preserve systemic stability. In such circumstances parties should be allowed to clear such contracts bilaterally.

4) Some contracts may by law be required to be cleared through specific clearing systems – for example CDS on Japanese corporate names may be required to be cleared through the Japanese derivative clearing system. Where a contract is deemed to be subject to the EU mandatory clearing requirement but is subject to an equivalent requirement, the EU

requirement must be framed so as to avoid a direct conflict of laws applicable to the relevant contract.

We understand that it is necessary for regulators to establish standards for clearing in order to comply with the mandate of the G20 governments. The issue, however, is that if 100% clearing is for any reason inappropriate, how are those standards to be established? There are two possibilities that we can see:-

(a) The use of standards for clearing set by a body such as ESMA would still be compliant with these commitments and also take into account the aforementioned issues. We would like to highlight the fact that the use of clearing standards by the "Fed letter" process has been successful.

(b) The adoption of a "comply or explain" approach whereby firms would be required either to clear contracts to provide the relevant regulator with a satisfactory justification of why the contract should remain unclear. Such an explanation should involve the firm demonstrating that the fact that the contract has not been cleared results in a positive risk reduction benefit to the firm.

It is worth noting that it is possibly wrong to regard the position as binary as between cleared and uncleared contracts – it should be possible for regulators to rule that particular contracts might be permissible as OTC contracts subject to minimum collateralisation requirements.

Where ESMA considers it appropriate to mandate clearing of a particular contract, there is a significant risk that different CCPs may – validly – believe that different methodologies should apply to the risks inherent in the relevant product, and this could in turn lead to significant systemic risk. Consequently, we believe that when considering whether to mandate clearing of a particular type of derivative, ESMA should consider not only the market for the derivative itself but also the existing mechanism used to assess the risks inherent in that product, and guidance as to its view as to these issues should be produced at the same time as its decision to mandate clearing of the relevant derivative. ESMA should also take account of the fact that, if its views on risk methodology are not accepted by the market, this mandate may in practice function as a prohibition of the derivative type concerned.

Finally, the imposition of a mandatory clearing requirement may have a significant impact on an existing trading market. Once the determination has been made that a particular contract is to be mandatorily cleared, market participants should be given a reasonable amount of time to develop new systems and controls, to raise money for margin requirements, to put appropriate documentation in place with clearing providers and to develop required risk control systems, without being required to close their business in the meantime.

(b) Clearing eligibility process

We support the clearing eligibility determination process as outlined in the consultation paper. However, we would highlight our view that

(a) clearing eligibility should be determined by a risk committee within the CCP rather than commercial management, since the overriding criteria involved in the determination as to whether a contract should be subject to a mandatory clearing obligation are risk issues and not commercial issues; and

(b) we are concerned that ESMA could designate a contract before any specific CCP was in position to offer clearing services for the relevant contract. This should not be allowed to happen.

The decision of national regulators in respect of any CCP notification of intention to clear a particular derivatives product should be based on a full review of pricing methodology, liquidity, the CCP's capabilities, and the ability of members to support a default process. These considerations should be enhanced by a full, public stakeholder consultation lasting no less than 3 months to allow full consideration of these matters and to ensure that risk reduction and not commercial aims are the drivers behind acceptance of a particular derivatives product as clearing eligible.

Additionally, it should be possible for contracts to be removed from the compulsory clearing list if either regulators or CCPs form the view that the conditions which were necessary for the initial decision to clear have ceased to exist.

Finally, it will be desirable to have appropriate phase-in periods so as to avoid distortions arising from trades which are caught by the mandatory clearing requirement but which are entered into in order to close out pre-existing uncleared trades

Consideration should be given to the inclusion of a de minimis threshold for financial firms in order to ensure that small financial firms should not be effectively prohibited from hedging idiosyncratic risks by the cost of establishing these processes.

(c) Access to CCPs

We agree that a CCP should be "open access" and execution venue agnostic. If two counterparties execute a trade on a product that is clearing eligible and uniform with equivalent cleared contracts, they should not be prohibited from clearing the contract on the basis of execution method. This however requires that the products traded be equivalent in legal and economic terms.

Section I (Clearing and Risk Mitigation of OTC Derivatives), Sub-sections 4 (Non-financial undertakings)

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

We agree with the general approach set out in the consultation and that certain parties should be exempt from a clearing obligation, as increased margin and operational requirements would be too burdensome and the reduction in systemic risk is insufficient to justify the imposition of these costs on the economy as a whole. We look forward to further clarity during the legislative process on the definition of non-financial institutions and appropriate exemptions for certain players who are significant users of derivatives.

We understand that the construction of an end-user exemption is likely to be complex, given the need to ensure that there is no regulatory arbitrage but also provide proportionality to non-financial users. OTC positions which are legitimate hedges should be exempt from any central clearing obligation. Such an obligation would affect corporates' ability to use derivatives for such risk management purposes, due to the significant liquidity burden posed by CCP collateral requirements.

With regard to determining the systemic importance of non-hedged exposures, nominal size limits are very unlikely to be either effective or efficient. Gross size of positions is not necessarily the best indicator of risk and, as has been made clear in other contexts, there is no hard and fast dividing line between systemic and non-systemic firms. Where banks are dealing with end-users, it will be extremely important to them to be able to know with certainty whether their transactions are subject to the mandatory clearing requirement or not. This is particularly important since, in any system based on size or numerical thresholds, it is likely that some counterparties may cross such thresholds (in either direction) over the course of the life of a transaction or within the context of a normal trading relationship.

(a) Clearing

We would support the European Commission asking ESMA to define the specific targets for clearing, capturing financial institutions, dealers and other systemically important firms. We believe that the emphasis should be maintained on the systemic stability objective of the clearing requirement, since if this is not done the danger is that the mechanic becomes clearing for the sake of clearing.

(b) Reporting to trade repositories

We believe that all cleared transactions should be reported to trade repositories and recognise the importance of regulatory transparency.

(c) Reporting to the market at large

In the context of public reporting we believe that there is a significant amount of work to be done in determining trade types; counterparty types; size thresholds; aggregation levels and delays, together with the consequences of such public transparency. We also believe that these will differ by asset class and transaction type. This would be best approached by the determination of guidelines which could then in turn be used to produce final determinations on these issues.

Section I (Clearing and Risk Mitigation of OTC Derivatives), Sub-sections 5 (Risk Mitigation Techniques for Non-Cleared Contracts)

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

Yes, we support this approach. However, we note the consultation document seems to suggest that collateral must be posted with respect to all non-cleared positions, including those with non-financial counterparties. It should be clarified whether this requirement is intended to only pertain to those positions exceeding the information/ clearing threshold, or those positions that are determined to not be clearing eligible. In any event, non-financial end users should not be required to post collateral or initial margin due to the significant liquidity risk this would create for them. Again, this is particularly significant in the case of corporates, which use derivatives to hedge their risk arising from their core activities/operations as their net exposure will be significantly smaller.

On a more general level, we note that we do not agree that "the risk management procedures must require timely and accurate exchange of collateral". We believe that subject to relevant capital standards and supervisory oversight (where applicable) parties active in the bilateral OTC derivative markets should have the responsibility and the authority to make decisions regarding the credit risk they assume, including the potential use of credit risk mitigation measures such as collateralistion, insurance or other credit enhancement techniques. It is not the case that best practice always in all cases requires collateralisation.

Section II (Requirements for Central Counterparties), Sub-sections: 1 (Organisational Requirements); 2 (Risk Committee); 3 (Conflicts of Interest); 4 (Outsourcing); 5 (Participation Requirements); and 6 (Transparency).

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

(a) Organisational requirements for CCPs

We support the approach to organisational requirements for CCPs set out in the consultation.

We note that the EC is not proposing to require CCPs to be authorised as credit institutions. We consider the current requirement by a number of Member States for CCPs operating in their jurisdictions to be authorised as credit institutions to be a significant barrier to the cross-border provision of CCP services ultimately increasing costs for investors. We therefore urge the EC to ensure that Member States cannot impose requirements on non-domestic CCPs beyond those set out in the coming EU CCP legislation.

(b) Risk Committees

We support the general principles set out in the consultation. In particular, we welcome the proposal to include representatives of clearing members on the Risk Committee and the proposal that the advice of the Risk committee will be independent of the executive management of the CCP. The Risk Committee must be composed of senior officers of the CCP and users who bear the default risk through contributions to the default fund. This is critical in order to ensure incentives are aligned when determining new clearing eligible products or other risk management decisions such whether and if how to interoperate with another CCP. While we understand the need to ensure the Risk Committee is objective, we question the inclusion of `independent administrators' (assumed to be comparable with 'independent directors') who are not financially committed in the same manner as the key CCP members. The mutualisation of risk is a key function of a CCP and representation on the Risk Committee without participation in default fund could misalign incentives, driving the CCP to look at commercial versus risk factors when accepting new products or members, for example. We also note that permitting clients and other indirect users of clearing services to be represented on the Risk Committee may have undesirable consequences, since such entities are only indirectly affected (if at all) by the levels of risk undertaken by the CCP. However, we welcome the proposal for the Risk Committee to establish a consultation mechanism that includes the clients of clearing members.

Risk Committees should be particularly closely involved in emergencies and in the management of defaults.

(c) Ownership of CCPs and conflicts of interest

We support the industry-owned utility model of CCP structuring. In this model the primary interest of the owners is not the generation of profits but the maximisation of stability and the minimisation of risk – consequently we do not believe that in CCPs where this model is used there is any significant risk of conflict of interest. This risk is further mitigated by (i) the presence of independent directors on the boards of the industry-owned utilities; (ii) the close attention paid by regulators; and (iii) objective criteria of membership by CCPs. Additionally:

(a) clearing members play a critical role in build out of utilities as there are few other parties incentivised to build under this economic model;

(b) members of the CCP underwrite the vast majority of risk of a CCP - margin, contributions to guarantee fund, assessment rights, default management;

(c) limiting the percentage level of investment that clearing members can make in CCPs will stifle competition and may push more product to for-profit natural monopolies;

Advantages of having clearing members as significant owners of CCPs are

- alignment with assumption of risk,
- prioritisation of human resources
- promoting innovation, (d) better management of sensitive trade-data,
- providing a legitimate forum to discuss and implement best practices

Negative consequences of restricting ownership would be

- significant pricing power for the winners,
- lack of core technical expertise to get right solution built quickly and
- fragmentation of clearing environment assuming major market participants continue to participate

We would also invite the European Commission to note that for-profit CCPs give rise to a natural conflict of interest, as their incentive is not wholly good risk management as they are also driven to maximise profits. This gives rise to the risk of commercial competitive pressure to lower risk management standards and possibly margin requirements which are not present in the industry-owned utility model. A CCP which is owned by an exchange or a particular bank or end users should be required to maintain at least the same level of independence as a CCP owned by its clearing members.

Finally, we do not believe that there is any basis for imposing any restriction on CCP ownership or participation where the ownership interest concerned is sufficiently small that the owner can have no significant impact on the governance of the CCP concerned; or where the ownership interest does not include governance rights, such as in the case of preferred shares.

(d) Participation requirements

We support the general approach outlined in the consultation and highlight that the CCP's ability to mutualise risk amongst its members is crucial. Robust membership requirements are therefore critical and the robustness of the mutualising process is a function of the financial robustness of the clearing members. Consequently although it is important for the CCP not to put artificial barriers to entry in place, it is reasonable and appropriate for CCPs to restrict membership to firms with sufficient financial strength, technical product capability and risk management track record. The appropriate restriction on CCP membership should be those members that can effectively manage a default of their fellow CCP members.

Specifically, the membership criteria must incorporate the following key requirements:

- Sufficient capital to meet the guaranty fund/ default fund commitment *and* additional commitments arising from post member default assessments and default fund recapitalisation. The CCP must ensure that the member can meet not only the ongoing risk requirement but these additional assessments following the default of another member.
- Ability to participate in risk mutualisation following member default, involving participation and bidding in the auction, and managing a variety of market risks involved in an OTC portfolio such as basis risk, bucket risk. This requires execution capabilities in the relevant OTC market. Note that all these risks cannot be sold into a commoditised market such as the futures market.
- Ability to rapidly price and subsequently risk manage a high volume of trades in a portfolio.
- Strong creditworthiness, reflecting the limited risk of a default of the participant as a clearing member.

Membership criteria should be objective and closely monitored. If a member no longer meets the membership criteria, it should not be allowed to bring additional risk to the CCP and should be required to reduce its risk position.

The procedures for members that no longer meet the membership criteria should include either or both of procedures for orderly suspension/ exit of members or potentially additional risk management requirements such as a higher margin multiplier for that member or an orderly reduction of market risk of the participant.

It is very important that the burden of risk mutualisation must be applied equally across the clearing members in a default management situation. Loss sharing criteria should be fair and objective, and additional contributions should be caped (and not unlimited). If members do not share the burdens of membership under the same terms (daily price submissions where you have positions, guaranty fund contributions according to the positions put into the CCP, requirements to assist in default management), there is little incentive for any one member to participate in these burdens. If stronger members are made to supplement weaker members, the quality of members overall will be weakened, as will the overall quality of the CCP.

We do not see how in this context ownership could be directly linked to "proportionality to risk" – risk exposures by definition change in real time, and may change significantly as a result of trading decisions entirely extraneous to the structure of the CCP.

We are however concerned about the requirement for a CCP to be informed by its members about the criteria and arrangements they adopt to allow their clients to access the services of the CCP. We do not believe that it is any part of the role of the CCP to police relationships between clearing member and client – that is properly the role of the financial regulator of the clearing member concerned.

(e) Transparency

We support the approach set out in the consultation, subject to any confidentiality obligations and intellectual property rights of a CCP. However, we believe that clearing members and prospective members must be given access to detailed information on risk methodologies in order to be able to make informed decisions on the robustness of individual CCPs

(f) Outsourcing

We believe that the outsourcing proposals to be contained in this legislation should be consistent with those of MiFID, and in particular the MiFID Level 2 Directive, both as to the definition of outsourcing and as to the requirements to be applied where an outsourcing is undertaken.

In this context, however, thought needs to be given to the consequences of a significant default. In this case a CCP may be required to involve market participants as collateral managers, transfer agents, managers in the closing out of portfolios and hedge managers for the CCPs net positions. All of these could conceivably be classed as outsourcings, but none of them should be prohibited under this rule.

Section II (Requirements for Central Counterparties), Sub-section: 7 (Segregation and Portability)

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

CCPs should be able to offer a variety of clearing models with different levels of segregation to suit the needs and requirements of different clients. In our view, it should be for the CCP to offer possibilities and for the client to decide what level of segregation and protection he wishes to obtain and at what price. In this context we would emphasise that while the CCP should make clear the various segregation options and the generic costs associated with each (e.g.: gross accounts result in higher costs to client), the specific costs that a client will pay are determined between the clients and its clearing broker.

Of critical importance is ensuring that national bankruptcy laws in no way frustrate the objectives of segregation and portability, or more generally the clearing proposals. Consequently, we endorse efforts to ensure that any such national provisions are set aside.

There appears to be some confusion in the paper about the transfer of client assets. A CCP holds assets as assets of the clearing member. A CCP may in certain circumstances deprive the clearing member of assets and credit them to the account of another clearing member, but the CCP has no direct contract or other legal relationship with the ultimate end client. Some legal structures (such as the assignment which forms the basis of the SwapClear Client Clearing system) may require the CCP in certain circumstances to transfer assets in this way, but these structures arise outside the clearing relationship between clearing member and CCP.

In addition, in relation to the fourth principle set out in (d), we would observe that it is difficult to prove with legal certainty that any model will completely insulate a participant from all credit risk, even when operating through a clearing member. Although residual risks may be negligible, the language of this principle should ensure that zero exposure under the counterparty risk rules of the Capital Requirements Directive may be available provided the risk to the CCP is also substantially mitigated.

Section II (Requirements for Central Counterparties), Sub-section: 8 (Prudential Requirements)

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?

The key prudential and risk management elements for a CCP are as follows:

(a) Guarantee fund, margin and CCP capital – these need to be of a reasonable size, with a clear waterfall and all parties having a well defined worst case loss

(b) Testing period – A CCP must have available clearly defined test criteria owned and regulated by the CCP which members must satisfy prior to commencing the clearing of any trades.

(c) Pricing methodology and quality control model – The CCP should not be able to decide the methodology for end-of-day pricing on an ad hoc basis that deviates from the agreed-upon methodology of its clearing membership and Risk Committee (unless an obvious error has been discovered).

(d) Margin methodology – to achieve effective risk management, CCPs must adopt margining suitable for OTC derivatives (as compared with listed derivatives).

(e) Default management process – Must be robust and constantly evolved, tailored to the products cleared, and rehearsed for the collapse of its biggest members on a regular basis.

In the event of a member default a CCP has access to

1) Required margin balances (initial and variation)

2) Default fund

3) CCP capital

It is important to be clear that these are not interchangeable concepts – the default fund contribution and the CCP capital cover different risks. In particular, the use which the CCP may make of the default fund is limited by the CCP's rules. Generally, a CCP may only apply the default fund to reduce losses suffered by it due a clearing member's failure to pay, after the application of that clearing member's margin to the loss, first applying the contributions of the defaulting clearing member before applying those of the other clearing members. Thus, unlike the capital held by a bank, which may be used as a buffer to absorb all types of loss, the default fund of a CCP is limited to protecting the CCP against the risk that one of its members might default on its outstanding contracts, and may only be disposed of in strict accordance with the conditions provided for in the CCP's rules.

However, CCPs also face other risks. A CCP will generally invest its own financial resources as well as the margin and default contributions of its members. The investment of such resources usually entails some risk of loss or illiquidity or both. In addition, like other market infrastructures, CCPs face operational risk, including legal risks relating to the enforceability of their default and netting arrangements. In addition, CCPs also face the risk of settlement bank failures. The risks which CCPs face which are unrelated to the default of a clearing member are, therefore, significant. However, they are risks in respect of which the default fund may not be applied, and must, therefore, be offset by the CCP's own capital, the level of which varies widely among different European CCPs.

The total default fund and capital of a CCP should cover the requirements set out by IOSCO – to cover the largest loss from the default of either (i) the largest clearing member; or (ii) the combined default of the 2nd and 3rd largest clearing members, although we believe that this should be extended to cover the default of the largest and second-largest members or the defaults of the 2nd, 3rd and 4th largest members together. We also believe that this assessment should be made using stressed rather than normal market estimates of these amounts, acknowledging that stressed conditions are most likely to occur upon the default of a major clearing major and hence resources should cover such an eventuality.

The interests of the shareholders of a CCP should be aligned with the aims of prudential risk management. Consequently shareholders of CCPs should be exposed to failures of that risk management process, and should not be shielded from such failure through recourse to default fund contributions. Furthermore, the use of robust initial margin requirements, coupled with daily variation margin, should be set to deal with any losses suffered by the CCP under stressed conditions. It is important that initial margin, as the first line of defence, is sufficient and CCPs should not compete by lowering initial requirements by either a) tradeoffs with default fund contributions, b) "look-back" period that only cover recent calmer times or c) use lower confidence levels. As such we believe harmonisation of risk methodologies is essential.

It is essential that there not be an approach which creates unlimited liability for clearing members as this would increase systemic risk. CCPs must be allowed to fail.

As mentioned above, a minimum level of capital at risk for the CCP must be obligatory to avoid moral hazard and to ensure that the CCP is correctly incentivised to build and manage a robust prudential and risk management process. However we do not understand the rationale for an absolute capital requirement (Xm EUR). Assuming that the risk requirements are appropriately calibrated by regulators, the only function of this limit would be to suggest – misleadingly – that any entity with Xm of capital is qualified to act as a CCP. The capital at risk should clearly be linked dynamically to the amount of risk carried by the CCP, so that its capital must rise according to a pre-determined regulatory formula as the CCP assumes greater risk. Note also, that the CCP capital should be structured in such a way so as to include a "first loss" pool of capital which would be mandatorily employed in the event of default by one or more members. The capital structure should also provide clear quantitative rules for replenishment of the CCP's capital position if it is depleted by unmutualised losses arising from member defaults.

Additionally, there must be distinctions between initial margin, variation margin and the default fund.

We agree that the confidence interval applied to initial margin should be at minimum 99% and could be required to be higher. In our view this should be validated by dynamically back-testing the effectiveness of the risk margin methodology over a historical period of at least five years to see how it meets its intended level of confidence in exposure coverage over the intended time horizon. This should be done with a set of reference portfolios that span the space of expected risk, and against actual clearing member and client portfolios on a regular basis. In our view, the more important component of the margin requirement calculation is the assumed liquidation period, and this later should be subjected to rigorous and continuous regulatory scrutiny, taking into account the specifics of the underlying product and bearing in mind that these specifics may change significantly from time to time. In cases of significant divergence from normal criteria it may be appropriate to raise the 99% threshold. We also note that while 99% confidence interval may be adequate for initial margin, the confidence interval for the default fund must be higher as it is designed to catch the outlier occurrence of the simultaneous default of the two largest CCP members.

In calculating margin requirements, it is essential that the CCP use an appropriate harmonised time horizon in calculating the volatility element of the margin requirement. Regulators should seek to ensure that CCPs do not compete inappropriately on this basis. All CCP risk models, parameters and procedures should be subject to initial as well as on-going review by appropriately qualified external, independent reviewers.

For example, we believe that the 5 day liquidation period that is the current best practice among CCP's, is only realistic in "normal" market conditions. The recently publicly released DTCC data show that for single name CDS trades the average number of trades per day is only 6 for US index constituents and 3 for non-index constituents. The data also reveal that non-index constituent names are typically five times less liquid than index constituent names under normal market conditions. Therefore, in periods of prolonged illiquidity or market dislocation, the effective period for exiting positions can be far longer than the suggested 5 days, particularly for larger and/or more complex portfolios. For Single Name CDS for instance, some names may see only a handful of trades in a two week period under normal conditions and far fewer trades in non-normal conditions. Further, the liquidation period may be substantially longer for less liquid names. Thought also needs to be given to setting different length holding periods for investment grade and high yield names, as well as setting different periods for index versus single name trades. Even in more liquid markets such as Rates, there may be significant basis risks which may be less liquid that require management by the Default Management Committee.

It is critical that the parameterisation of the margin calculation is sufficiently conservative to take into account concentration at different levels (entity/ industry/ jurisdiction/ system), considerations regarding treatment of "wrong way risk" including in relation to initial margin deposited by market participants, as well as the liquidity and spread behavior in a default scenario. Back testing of margin parameters must take account the simultaneous adverse movement of realistic combinations of input variables that have been witnessed during severe market dislocations, rather than examining parameter changes sequentially or in isolation. We fully agree with the requirement for intra-day monitoring of member positions and margin levels and strongly suggest that such monitoring should include quantitative limits for margin calls and that such calls should occur in an automated fashion in the event that the agreed thresholds are breached.

We would note that there are good economic reasons why interest (known as Price Alignment Interest (PAI)) should continue to be paid on the cumulative mark-to-market when an OTC contract clears through a central counterparty (CCP), notwithstanding that PAI is not paid on the cumulative mark-to-market for futures contracts.

In the context of risk management between interoperating CCPs, we are concerned that the proposal that a CCP 'fully collateralises its exposures' may hard-wire a very inefficient model of inter-CCP risk management into EU legislation. To ensure progress on CCP interoperability, the relevant stakeholders (regulators, CCPs and their members) have agreed to support in principle an inter-CCP risk management model based on the full collateralisation of exposures through margin exchange. All stakeholders agree that this model is sub-optimal in terms of collateral usage and are committed to improving it as soon as possible. Providing there is no negative impact on inter-CCP risk management, EU legislation should not preclude any future efficiency improvements that are agreed with relevant competent authorities.

Finally, the investment policy of CCPs should be regulated with a view to the inherent liquidity exposures to which they are subject. As counterparty to each of its clearing members, a CCP must ensure that it is in a position to meet its payment obligations to members within transaction deadlines, including where one of its members defaults. CCPs are therefore exposed to significant liquidity risk which will usually need to be reflected in their investment strategies.

We believe that such regulation is necessary for the stability of the market as a whole, and for the purposes of preserving confidence in CCPs. Like a bank, a CCP borrows in the short term in the form of margin and fund contributions, in order to lend in the long term in the form of its investments. In the same way that banks may be subject to a "bank run", whereby a large number of depositors seek to withdraw their deposits due to concerns that the bank may become insolvent, a CCP could potentially be the subject of "CCP run". A run on a CCP could arise where the clearing members become concerned about the CCP's financial well-being as a result of one or more members having defaulted or soon to be in default. Clearing members, concerned about the CCP's financial position, could seek to close out positions with the CCP A in order to open the same positions with CCP B with the intention of preserving their collateral from the risk of exposure to the CCP A. Although the return of excess margin is subject to certain conditions under the regulations of some CCPs, where a clearing member has no open positions and no outstanding payment obligations to a CCP, it is unlikely that a CCP could reasonably act to block such a withdrawal.

CCPs are not generally subject to external limitations on their investment strategies; however, in some cases the CCP may publish an investment policy or include provisions governing its investment strategy in relation to member margin and default contributions in its rules. Notwithstanding such provisions or policies, the CCP generally retains a great deal of discretion as to its investment policy[2].

[2] By way of example, the rules of European Central Counterparty Limited ("EuroCCP") provide that cash, collateral and the default fund may be partially or wholly invested by EuroCCP in securities issued or guaranteed by governments chosen by EuroCCP or "such other investments authorised for the purpose under the investment policy adopted from time to time by [EuroCCP]". Cash funds are deposited by EuroCCP in its name with a bank or depository institution selected by EuroCCP. European Multilateral Clearing Facility N.V. ("EMCF") has published guidelines relating to its investment strategy in its Clearing Fund Regulation. The Regulation provides that such guidelines will have the primary aim of minimising the potential loss of principal and will ensure that the assets are invested in assets with daily liquidity to enable them to be called upon on a daily basis. Subject to achieving capital preservation and liquidity, EMCF will then seek a return on the assets of the default fund, as close as possible to money market returns through diversified investments designed to minimise principal and concentration risk. Subject to the above conditions, EMCF may invest the default fund assets with a central bank or a commercial bank with investment grade rating with both Moody’s and Standard & Poors, in accounts which can be liquidated daily. In the case of other CCPs, such as LCH.Clearnet Limited, there is nothing in the clearing house's

The CCP's regulator should ensure that it provides adequately for its liquidity needs. For example, the regulator will wish to ensure that the CCP does not concentrate risk in one counterparty, for example, by depositing default funds with the same bank that also acts as its settlement bank. Some degree of concentration seems inevitable, however, given that frequently a CCP's treasury functions will involve contractual relationships with counterparties who are themselves clearing members of the CCP.

Section II (Requirements for Central Counterparties), Sub-section: 8 (Prudential Requirements)

Should the default fund be mandatory and what risk should it cover?

Yes, the default fund should be mandatory.

Mutualisation of losses among clearing members is necessary for a CCP to operate and one of the central tenets that incentivises appropriate risk management behaviour among members. The potential size of the default fund is – in principle at least – very sensitive to the initial margin levels the CCP charges on cleared products. Lowering / increasing of initial margins would have a direct impact on the size of the required default fund (which moves in the opposite direction as initial margin). Therefore, CCPs should be discouraged from lowering initial margin levels (possibly due to commercial/competitive pressures) to the detriment of the clearing members who would then need to contribute to a larger default fund to cover the difference, which in effect represents a subsidy to indirect participants who would otherwise have contributed higher risk cover.

We also suggest that given the social utility a CCP provides to all market participants, requiring default fund contributions from all CCP users merits consideration.

A clear and quantitatively specific process must be defined for the recapitalisation of the default fund following member defaults, including additional member assessments. We also believe that it is important to develop a "living will" for the CCP in order to deal with possible insolvency. This is particularly important as there is no clear statement of what happens in the event of final unmutualised losses.

With regard to default fund size, the current market practice is to look at covering the largest loss (above initial margin collected) from the default of either (i) the largest clearing member; or (ii) the combined default of the 2nd and 3rd largest clearing members. The overall size of the default fund should be reviewed regularly (by CCP risk executive and committees) to decide if the default fund itself needs increasing.

rules to limit its investment strategy. However, in practice CCPs have generally adopted a conservative investment policy due to their specific liquidity needs.

Clearing members must be able to cap their losses, e.g. through their termination of participation in the CCPs in accordance with pre-determined timescales set out in the CCP's rules.

Section II (Requirements for Central Counterparties), Sub-section: 8 (Prudential Requirements)

Should the rank of different lines of defence of a CCP be specified?

Yes, see above response to first Prudential Requirements Question (Do stakeholders share the general approach set out above on prudential requirements for CCPs?).

With regard to default procedures, we strongly support the inclusion of details of a CCP's emergency powers/procedures in the rules and regulations of the CCP. For the purposes of this requirement, there should be coverage of emergency powers/procedures relating to any financial powers (ie, rights of replenishment or the ability to draw additional margin) as well as procedures (ie, rights to force-allocate or invoice-back trades). It is of paramount importance that there is full transparency as to the potential liabilities and the position of those liabilities in the financial waterfall that Clearing Members may face as a result of their clearing obligations, so that potential Members can make the appropriate commercial judgements as to their capacity to face the CCP.

In particular, we would note the need for clarity with respect to emergency powers of invoicing or forced allocation. To the extent that exercise of such powers could give rise to the effect of clearing never having happened in the first place, the conditions and mechanism of their potential use should be a) appropriate and b) clearly specified.

With regard to the sub-section on "other risk controls", the provision "Each clearing member…should not be able to provide more than 10 percent of the credit lines as needed by the CCP" may not be realistic particularly in the cross-border context where CCP may not have access to central bank liquidity - in fact we would want the clearing members to be the main providers of credit lines to the CCP as CCP membership criteria would be calibrated to include entities which would have the capacity to provide credit lines to a CCP.

Section II (Requirements for Central Counterparties), Sub-section: 8 (Prudential Requirements)

Will the collateral requirements and investment policy ensure that CCPs will not be exposed to external risks?

Yes. Similar to margin, the collateral and investment policies of a CCP should take into account considerations regarding "wrong way risk" where the CCP could be increasing exposure to particular entities, jurisdictions or sectors.

There is considerable variation between CCPs as regards permissible investments, and we believe that harmonisation of requirements in this regard would inhibit the risk of CCPs seeking to gain competitive advantage over each other by increasing their risk exposure (and therefore their returns) in this way. We therefore agree with the proposal to come up with a list of highly liquid "investable" instruments and concentration limits. However, any such list should be made subject to periodic review. That said, we note that restrictions on investments will have direct implications on the returns available for users, with any reduction in available returns representing a direct cost of clearing to all CCP users.

Each CCP must formally monitor the risk of its investment strategies and instruments, using a consistent and clear measure (VaR, stress testing, etc) and potentially to set up VaR limits and other relevant controls.

Communication and reporting of the invested instruments/strategies and associated risk measures should be formally reported to the risk committee on quarterly basis.

In the 'Investment Policy' sub-section, the EC proposes that 'Financial instruments posted as margins should be deposited with operators of securities settlement systems[s]…'. Referring to current market practice, we request the EC clarify the meaning of securities settlement systems' – is this limited to Central Securities Depositories or does it include agent banks?

Section II (Requirements for Central Counterparties), Sub-section: 8 (Prudential Requirements)

Will the provisions ensure the correct management of a default situation?

We are supportive of the principles set out in the consultation. However we would note that the management of a default is likely to occur under high levels of commercial and time pressure, and it is in this context that operational risk loss is most likely. We therefore note that it would be unwise to assume that any set of controls will eliminate all risk arising out of default situations.

CCPs should also be required to run regular fire drills (i.e. default simulations) to ensure all affected parties are entirely familiar with the processes involved with such an event.

We are strongly of the view that robust, contractual and transparent default management procedures are the first line of defence for the CCP and its members; and that the evaluation of the adequateness of such arrangements is key to the determination of required levels of margin and other financial resources and to the overall robustness of the CCP.

Section II (Requirements for Central Counterparties), Sub-section: 8 (Prudential Requirements)

Are the provisions above sufficient to ensure access to central bank liquidity without compromising central banks' independence?

We do not necessarily accept that it is always desirable for a CCP to have access to central bank money – this could have the effect of creating moral hazard for the relevant central bank. This seems to be a point which would merit further consideration form a macro-economic perspective.

Significantly, we are concerned that any obligation for CCPs to deposits cash with Central Banks may depress investment returns with the consequence it deters the use of cash collateral in favour of non-cash collateral. Such a behavioural shift by CCP users to use non-cash collateral would result in liquidity stress in the event of a member default, necessitating access to Central Bank sources of liquidity.

Section II (Requirements for Central Counterparties), Sub-section: 9 (Relations with Third Countries)

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?

The discussion of the issues as to passporting disregards the most important issue which arise in the context of the derivatives market. Pursuant to the G20 mandate, all major economies will have an equivalent mandate to clear derivatives. Thus any derivative transaction between two institutions incorporated in any two G20 countries will be subject to at least two competing clearing mandates. Provided that these mandates simply require central clearing, this is unproblematic. However, if these mandates require clearing through national systems, then almost every derivative will be subject to competing and potentially conflicting clearing requirements. It cannot be overemphasised that a derivative cannot be cleared through two different CCPs, and if the rules require this then the rules in effect prohibit that derivative.

Once all of the relevant systems are established and have a track record it may be possible to establish a mutual recognition regime. However for the time being, in order to create an international mandatory derivatives clearing regime, it will be appropriate for at least G20 members to accept that clearing is clearing, regardless of where it occurs.

We also strongly support fair and open reciprocal access to third country CCPs, clearing members and customers, and believe international regulators should work to inhibit the creation of our national barriers to this objective.

Section III (Interoperability)

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

We welcome the proposal to incorporate CCP interoperability into EU legislation. As users of CCPs we have been disappointed by the slow progress of CCP interoperability under the EU Code of Conduct on Clearing and Settlement. Subject to our comments below on the substance of the EC proposals, we believe that EU rules providing CCPs with a conditional right to interoperate with other CCPs and to access other necessary market infrastructures will help to ensure progress towards competitive, efficient and safe pan-European clearing.

Referring to section III, subsection 1 (Interoperability) we support the proposal to provide CCPs with a right to interoperate with another CCPs and to relevant access trade data and settlement systems providing the requirements in subsection 2 (Managing Risk Arising from an Interoperability Arrangement) are met. In addition, to address a fundamental flaw of EU Code of Conduct, we propose that the EU legislation include provision(s) providing that the conditional right of access for CCPs to trade feeds and settlement systems be extended to jurisdictions or markets where there is currently no CCP.

Referring to section III, subsection 2 (managing Risks Arising from an Interoperability Arrangements), we support the European Commission's proposal to limit the right to interoperability to cash instruments. We believe that interoperability is inappropriate for OTC derivative products at this time due to the tailored nature of these products compared to the more standardised cash equities asset class. We are supportive of attempts to develop portability of positions between CCPs to reduce open risk following a default of a Clearing Member or in the case of credit derivatives, default of an underlying reference entity; however, we do not believe that the issues involved in such proposals are sufficiently well understood at this point to be the subject of legislation.

We emphasise that the issues which arise in this context in the cash markets are entirely different from those which arise in the derivative markets, and that it is wholly in appropriate to seek to apply in one market principles developed in the other. If it is intended to extend an interoperability regime to derivative CCPs, we believe that detailed consultation should be carried out as to the modalities which would be imposed in respect of such interoperability, including identification of risk models and collateralisation protocols. Moreover, a convincing case has not yet been made for interoperability between CCPs clearing derivatives instruments: We would disagree with the generalisations regarding the OTC derivatives market, such as the statement that "the post-trade sector remains fragmented along national lines". These generalisations are not applicable to the OTC markets, where centralised, international CCPs and industry practices are the norm.

Where interoperability is planned across borders, it should be approached in conjunction with global co-ordination among regulators along the lines of the CPSS/IOSCO guidelines. The establishment of a global standard for recognition would be a positive step, and would avoid the risk of fragmentation of the derivatives markets along EU/US/RoW fault lines. The more global the standard, the better of users are likely to be.

Reflecting longstanding market demand, CCPs have together with their users and regulators for some time been working together towards CCP interoperability for cash equity instruments. Referring to the need to progress this work and the general satisfaction with current state of CCP interoperability in the fixed income securities environment (as demonstrated by e.g. the longstanding CC&G - LCH.Clearnet SA link) we propose that the interoperability proposals apply initially only to cash equity instruments and that their possible later application to fixed income cash instruments be made subject to a review at predetermined future date.

In terms of the proposed requirements for managing the additional risks arising from interoperability arrangements and the need for prior regulatory approval of those arrangements, we support the general approach taken by the EC. Noting the high-level nature of the proposals, we believe the 12-02-10 'Communication of Regulatory Position on Interoperability by AFM, DNB, FINMA, FSA and SNB' (attached) would be a helpful basis for the development of more detailed EC proposals. In addition to the requirements in the Communication, we suggest the EC incorporate requirements: for CCPs to be transparent vis-à-vis their members on the proposed interoperability arrangements; for a maximum timeline for affected stakeholders to process interoperability and/or access requests; and for a timed and Competent Authority overseen appeal mechanism where interoperability and/or access is denied.

With respect to transparency: we believe that CCP members must be able to carry out proper due diligence on the risks to which they are exposed through their CCP(s)' proposed interoperability arrangements. To this end, we believe that CCP members should well in advance of the launch of an interoperability arrangement be given access to the data necessary to carry out a full assessment of their CCP(s)' proposals for measuring, monitoring and managing the risks arising from interoperability.

To prevent unjustified delays, we suggest the interoperability provisions outline a generic timeframe for the application process from requesting interoperability and/or access through to launch including potential response time from the relevant Competent Authorities.

To guard against commercially motivated protectionism we believe the interoperability provisions should include a timed appeal mechanism for use in cases where there is a denial of interoperability, data feed and/or settlement system access. Drawing on lessons learned under Code of Conduct (in particular, the lack of enforcement) we believe it critical that CCP legislation includes provisions giving Competent Authority responsibility and accountability for overseeing that process .

Section IV (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.

It is important in this context to make the distinction between position disclosure and transaction disclosure. We fully support the disclosure of position information to regulators, in order to enable them to view the current outstanding market exposures of any given market participant. We also fully support the disclosure of transaction information to regulators within the current trade reporting obligation.

(a) Reporting obligation

We support Option B with regard to this issue, as we believe that trade repositories need to have on record all open derivative contracts in order to ensure that regulators have the most comprehensive information possible. Option A would seemingly leave out transactions by non-financial firms (there seems to be no requirement for these parties to report them to trade repositories) – this would be particular acute in the commodities space as many transactions in this asset class are between non-financial institutions. With regard to Option B, the European Commission should look to eliminate duplicative reporting as well to ensure accuracy of data and avoid potential systemic risk. We should also ensure that reporting requirements to trade repositories are not expanding existing transaction reporting requirements.

Current industry processes across the asset classes do not conform to the reporting standards as laid out in the consultation document, with the exception of the majority of Credit Derivatives which are reported weekly to DTCC’s Trade Information Warehouse. Rates and Equity are currently reported monthly, although it is planned to increase the frequency of Rates and Equity population to weekly. If the regulators were to seek to increase the population frequency to daily we would recommend that given the additional cost implication of this, the benefits case of such action is fully explored between regulators and market participants, the end goal of the Trade Repositories should be clearly articulated, and also opportunities to leverage efficiencies between this new requirement and existing forms of transparency and reporting should be sought.

Trade repositories contain positional information and are a good source of open interest data. The trading activity through which these positions have been established is not currently transparent via trade repositories. DTCC’s Trade Information Warehouse contains transaction level data which can be used to establish trading activity that makes up a given Warehouse position.

Finally, a requirement to "report details to a Trade Repository no later than the working day following the execution …." may be problematic given that on occasion not all trade capture is performed within Trade Date in the time-zone of reporting.

(b) Registration of trade repositories

We support Option 2, as we believe that one global repository per asset class provides the required visibility over open interest per counterparty per asset class. We would also emphasise that we do not accept that it is necessarily the case that a new institution should be established to perform this function in every case. There may well be circumstances in which existing infrastructure (such as Trayport) can be reconfigured to have repository functionality.

Within asset classes, however, we believe that the development of separate regional repositories could be both damaging and counterproductive. The fragmentation of information that could arise with the implementation of regional repositories increases operational overhead costs, but more importantly adds the risk of duplicative reporting of transaction information, and furthermore increases the risk that some trades are reported on in neither location.

We believe that any third country trade repository recognised by ESMA must comply with all the European standards. With regard to unfettered access for regulators, we believe that this should be required in order to be registered in the EU and a condition in the cooperation agreement between ESMA and the third-country competent authority.

We are very much against the idea of a European public utility as a trade repository based on the fact that utility structures are already in existence and function well and serve the systemic risk management needs of regulators in providing a global snapshot of the asset class in question.

Section IV (Reporting Obligation and Requirements for Trade Repositories)

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?

With regard to transparency, we believe that the information published by trade repositories should only be available to competent authorities, e.g. national supervisors and ESMA and Central Banks only in the case of their monetary policy function (and therefore only for FX products).