DACSI Dutch Advisory Committee Securities Industry

Consultation response

DACSI 10-1099
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DACSI's * response to the European Commission's public consultation on Derivatives and Market Infrastructures.

Introduction
DACSI is fully supportive of the Commission's objective of reducing risk in the financial system and recognises that central clearing should play a key role in achieving that goal. We take this opportunity to comment to several aspects touched upon in the consultation document in order to increase the effectiveness and clarity of the proposed Regulation.
In this respect we have some concerns with regard to the overall regulatory framework. For market participants it would be helpful to get a better explanation of and insight into the structure and scope of the proposed Regulation vis-à-vis the new Securities Law Directive and MiFID, and their boundaries.

I. Clearing and risk mitigation

I.1. Clearing obligation

We fully support the bottom-up approach for determining contract eligibility.
We would not support the top-down approach. Labelling a product "eligible" when no CCP has taken the initiative to become clearer could easily generate unwanted effects. Suppose ESMA determines a certain product subject to the clearing obligation, and no CCP effectively starts clearing (either because of its own risk or cost oriented considerations, or for regulatory reasons). In such a case, the product would implicitly be forbidden to trade. That would be counter to standard free-market policy and could prevent parties from undertaking transactions that would be needed for their proper risk management.

In case only one CCP will act as clearer in a product (class), a strict clearing obligation will require safeguarding of other competition-driven conditions like pricing.

I.2. Non-financial undertakings

The criteria for determining which undertakings and transactions are subject to the CCP obligation are ambiguous from two perspectives:

a. a particular transaction can only be guaranteed by a CCP for both sides, not for one side only. For transactions in which one of the counterparties would be exempt from the CCP obligation, the Regulation should specify that such a transaction does not require CCP clearing;
b. the combined institutional criteria (status of financial institution) and functional criteria (position thresholds) are not always consistent and do not always contribute to a reduction of risk in the financial system: risk in the financial system can be driven by exposures and/or transactions, regardless of the institutional status of the transacting party. A clear set of functional criteria – following the lines of information and clearing thresholds, focusing on positions *and* transactions, and on their purpose – would be most effective for the required risk reduction while avoiding unnecessary burdens for non-financial *and* financial undertakings.

I.3. Risk-mitigation techniques

Many financial and non-financial organisations manage their exposures by a wide variety of products/instruments. Bilateral and multilateral (CCP and other) clearing arrangements should ensure that a maximum netting effect is achieved. That results in lower overall margins, but also reflects an actual risk reduction. Hence, in certain circumstances, non-central clearing has a higher contribution to the EC's objective of risk reduction than a CCP solution. Therefore, parties – financials and non-financials alike – should have the option to use alternative risk-mitigation techniques even when they transact in an eligible product. We would prefer a regime of "comply or explain" above a rigid "always comply" regime.

II. Requirements for central counterparties

II.1. Organisational requirements

We subscribe to the principles and requirements set out for a CCP's Risk Committee, and underline the following:

- risk management, including margining and default funds, should in many cases be separated per product class;
- the scope of the Risk Committee should be an overall one, covering all product classes and exposures.

II.2. Segregation and portability

We support the basic ideas laid down in this section. However, what is described in the consultation document, is partly in contrast to current legal arrangements in several countries. Although the Regulation would be binding with immediate effect, a *"rude"* implementation may result in inconsistencies in the total national legal framework. We do not expect that the Regulation itself will create consistent and adequate legislation at a national level. Therefore, we would ask for a careful implementation of the ideas, which should be supplemented by amendments in national legal arrangements.

II.3. Prudential requirements

It is quite possible that a CCP's lines of defence (margin, capital, others) are adequate without a default fund. Hence, the trade-off between strong capitalisation and establishing a default fund could be left to a CCP and its regulator. However, if a default fund is installed, the ranking of the different lines should be as follows: 1. margins of the defaulting clearing member, 2. default fund contribution of the defaulting member, 3. CCP's capital, 4. default fund and other contributions of the non-defaulting clearing members. Especially for not-user-owned CCPs, this ranking is necessary for a justified balance between decision makers and risk bearers.

We do not understand the rationale behind an *absolute* amount being required as the CCP's initial capital. As the product (range) and various circumstances will most significantly influence what capital would be needed for an orderly wind-down or restructuring, the required initial capital should be derived from those factors, using criteria or rules to be applied amongst relevant authorities to the maximum extent. Introducing an absolute amount would be inconsistent with such an approach, or – if set low – be ineffective.

III. Interoperability

We strongly agree that the rules for interoperability should only apply to cash instruments, as specifying rules applicable to derivatives would be far too complex at this stage.
Introducing interoperability between CCPs will be complex in terms of risks, costs and procedures. We do not believe that the introduction of (the right to) interoperability contributes to the objective of the Regulation: risk reduction in the financial system. The subject is rather a "left-over" from the Giovannini barriers and the consequent Code of Conduct, which focused less on risk reduction but rather on more competition aspects like price transparency and service unbundling.
As the subject is on the actual agenda between infrastructure providers and their users, and as regulators are assessing actual proposals by providers, a thorough debate between providers and users is anticipated. In our opinion, arrangements on interoperability should be outside the scope of the Regulation.
However, if rules around interoperability would be included in the regulation, the conditions around access rights for CCPs to trading data should be made more explicit to ensure their effectiveness.

IV. Reporting obligation and requirements for trade repositories

Any reporting obligation should be designed at least in full consistency with existing transaction reporting obligations, and should possibly replace them, in order to minimise the administrative burden, both for the reporting entities, and for the repositories themselves and their primary users (regulators).

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