Deutsche Börse Group

Response to European Commission

“Public Consultation on Derivatives and Market Infrastructure”

8 July 2010
I. Introduction

Deutsche Börse Group welcomes the opportunity to provide comments on the 14 June 2010 consultative report, “Public Consultation on Derivatives and Market Infrastructure,” of the European Commission. We recognize that the consultative report is not a legislative proposal but rather a working document in which the Directorate General Internal Market and Services has presented preliminary views for comment on four specific areas including clearing and risk mitigation of over-the-counter OTC derivatives; requirements for central counterparties; interoperability; and reporting obligations and requirements for trade repositories. We find this an important step in the legislative process. Given the significance of the proposals for the financial system, we would also welcome being able to provide comments once the legislative wording is drafted.

Deutsche Börse Group provides investors, financial institutions, and other companies access to global capital markets and covers the entire process chain from securities and derivatives trading, clearing, settlement and custody, through to market data and the development and operation of electronic trading systems.

Xetra, Deutsche Börse’s fully electronic trading platform, is one of the world’s most powerful fully integrated trading systems for securities. Xetra has been enhanced on an ongoing basis since its launch in 1997 to meet the requirements of the trading world and offers an efficient, high performance system. Traders have access to a comprehensive range of German and international equities and other securities via Xetra trading screens. Xetra sets standards in securities trading with respect to liquidity, transparency, speed, and flexibility, independent of location and at a low cost.

Eurex, jointly owned by Deutsche Börse AG and SIX Swiss Exchange AG, is one of the world’s largest derivatives exchanges. It provides an extensive range of products, including some of the world’s most heavily traded derivative contracts.

Eurex Clearing AG provides clearing services for listed futures and options products, stocks, bond and repo transactions, and certain OTC markets, for example via Eurex Credit Clear. Its resilient and robust central counterparty clearing model has proven to be an important stabilizing factor in the global financial markets during recent times. Eurex Clearing sets industry leading standards with its real-time risk management and intraday margining.

Clearstream, a wholly owned subsidiary of Deutsche Börse, is a leading European supplier of post-trading services. Clearstream ensures that cash and securities are promptly and effectively delivered between trading parties as well as manages, safekeeps and administers the securities that it holds on behalf of its customers. Over 300,000 domestic and internationally traded bonds, equities and investment funds are currently deposited with Clearstream.

On 31 May 2010, Clearstream announced that it was joining BME Bolsas y Mercados Españoles’ trade repository project providing reporting services for a wide range of OTC financial instruments. The initiative will contribute to achieving greater operational control and transparency in OTC derivatives. The new trade repository will serve all financial institutions as
well as non-financial institutions and will deliver flexible participation levels that adapt to the diverse profiles and needs of all stakeholders and actors in the OTC derivatives market.

II. Comments

A. Overall comments

The financial crisis brought flaws in the financial system to light, including problems related to the use of OTC derivatives, where a lack of adequate regulation, transparency, and effective risk management and mitigation were identified. At the same time, the crisis highlighted the effectiveness and benefits of market infrastructures—including exchanges, central counterparty clearinghouses (CCPs), and central securities depositories (CSDs)—in improving market integrity and stability.

Well-designed CCPs with appropriate risk management arrangements reduce systemic risk through effectively reducing and managing counterparty risks, creating transparency on positions, and helping to ensure the operational efficiency of the market. As such, CCPs contribute to maintaining market confidence and liquidity in times of stress and facilitate the goal of financial stability.

In the wake of the default of Lehman Brothers in September 2008, this stabilizing role was validated. As one of the largest OTC and exchange-traded derivatives players, Lehman was the counterparty on numerous derivatives contracts. In the case of centrally cleared derivatives, CCPs achieved a near-complete resolution for all open positions within less than 15 trading days. Additionally, CCPs were able to effectively shield the accounts of market participants trading through Lehman from the effects of its bankruptcy. In this way, CCPs mitigated market disruptions and prevented spillover effects, thus minimizing risks to all parties involved.

Global regulators and policymakers have recognized the stabilizing function of market infrastructure and have launched multiple initiatives to encourage:

1. Increased derivatives trading on organized trading venues;
2. Use of central counterparties where trading on organized markets is not feasible;
3. Bilateral collateralization of derivatives exposure when organized trading or the use of CCPs is not feasible;
4. Mandatory registration of open risk positions and reporting standards for all derivative contracts.

Most notably, these initiatives were highlighted in the G20 Leaders’ Statement from September 2009: “All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements” and reemphasized in more recent statements including the G20 Toronto Summit Declaration from June 2010. In the EU, the view was reinforced in October 2009 by the Council of the European Union, which formally tasked the
Commission with examining possible future solutions. In the EU, implementation of this policy goal is underway through this legislative initiative (to address use of CCPs and trade repositories for OTC derivatives), as well as adaptations to the Capital Requirements Directive (to address higher capital requirements for non-CCP cleared OTC derivatives) and the Markets in Financial Instruments Directive (to address increased derivatives trading on organized markets), among others. In parallel, these initiatives as well as additional initiatives—such as revisions to the CPSS-IOSCO recommendations for CCPs—have been launched with a focus on ensuring that CCPs are equipped to handle the anticipated increases in volumes and complexity.

B. Summary of views on key topics included in consultation document

- **Interoperability contrary to global policy aims:** We believe that the Commission should focus on the implementation of the G20 mandate on sustaining market stability and integrity through CCP clearing (as well as exchange trading and registration) of OTC derivatives and leave interoperability for cash equities out of this legislative proposal. The issue of interoperability for cash equities requires a separate debate and an appropriate impact assessment. More specifically, we believe that mandating interoperability for cash equities not only distracts from the required policy agenda, but in fact works against the aims of increasing market integrity and stability, while also reducing market efficiency. It increases systemic risk, brings additional unwanted costs to the market, and drives fragmentation in the post-trade area.

- **Access to CCPs only on basis of risk management assessment:** A CCP authorized to clear eligible OTC derivatives contracts will grant access to those services based on its participation requirements. Furthermore, CCPs should be able to decide on the basis of their risk management requirements whether to connect trading platforms to the services of the CCP for OTC derivatives clearing services. Unconditional access cannot be assumed possible given legal and technical complexities.

- **Binding harmonized standards on the strictest level:** The Commission should ensure the definition of binding harmonized strong standards on a European basis and that potential differences in national implementation of the legislation are avoided. The legislative text on which technical standards and guidelines are developed should be clear and unambiguous and contain a sufficient level of detail to ensure that the European Supervisory Authorities including the European Securities Market Authority (ESMA) together with the European System of Central Banks (ESCB) is charged with defining technical standards rather than policy direction.

The prudential requirements presented in the consultation appear appropriate and reasonable, but some important details require adjustment, as we highlight in our response below. Furthermore, it should also be specified by the Commission where the requirements are similar or different to CPSS-IOSCO and ESCB-CESR Recommendations for CCPs.

- **CCPs require a special purpose banking license:** We also point out that a banking license for CCPs is currently required in at least two EU countries (France and Germany). The consultation document, however, does not cover introduction of a harmonized
regulatory status either as a bank or a special CCP license. We recommend that a status as “special purpose bank” be created for all EU CCPs to harmonize European requirements.

- **Advisory role of Risk Committee:** We believe that the scope of the Risk Committee as described is too far reaching and opens up the potential for conflicts of interest that threaten the integrity of the CCP. Given the diverging interest between risk appetite and margin level from market participants, it should be ensured that CCPs as risk managers remain neutral and independent from the influence of risk-takers. As such, it should be clearly recognized that decision-making on risk management measures rests solely with the CCP management and oversight on risk management solely with regulators. The Committee should be seen strictly as a sounding board and advisory group for the Executive Management of the CCP. To address conflicts of interest between Clearing Members and their clients (buy-side and sell-side) properly, the Risk Committee should be comprised of an even split of Clearing Members and clients of Clearing Members, in addition to independent industry experts.

- **Relations with third countries:** CCPs and trade repositories should be located, operated and supervised in the European Union. This is important to ensure that strong prudential standards for risk management are not compromised. It also ensures EU regulator and supervisor access to necessary data in all situations and increases legal and regulatory certainty, ensuring risk mitigation, data quality, and transparency objectives are fulfilled.

- **Global alignment:** Global initiatives must remain closely aligned to ensure an appropriate and clear regulatory framework for all entities affected.

**C. Specific comments and responses to questions and suggestions to consultation text**

“The Commission services envisage that the necessary technical standards and guidelines will need to be developed by ESMA - in some instances with the cooperation of either the European Banking Authority or the ESCB.” (page 2).

The Commission should ensure the definition of binding harmonized strong standards on a European basis and that potential differences in national implementation of the legislation are avoided (“level playing field”). The legislative text on which technical standards and guidelines are developed should be clear and unambiguous and contain a sufficient level of detail to ensure that the European Supervisory Authorities including the European Securities Market Authority (ESMA) or the European System of Central Banks (ESCB) is charged with defining technical standards rather than policy direction.

**I. Clearing and Risk Mitigation of OTC Derivatives**

**What are stakeholders' views on the clearing obligation, the process to determine the eligibility of OTC derivate contracts for mandatory clearing, and its application?**

**DBG specific comments and responses to questions:**

**I. Clearing obligation:** With regard to a clearing obligation, we believe that in order to meet global objectives to increase centralized clearing of OTC derivatives, further standardization would need to be pursued where possible. For example, if a certain product (group) is relevant or
becomes relevant from a systemic risk point of view, standardization should be pursued in order to increase liquidity and allow fair and transparent pricing to provide a basis to centrally manage the risks of such products, i.e. allow CCP clearing. Such standardization efforts should be fulfilled through a joint effort of market participants, CCPs, and relevant regulators and supervisors.

We also point out that the G20 calls on central clearing of all “standardized” OTC derivatives, not just standardized OTC derivatives that pose a systemic risk. We would suggest that the Commission adjust its proposal accordingly.

In this respect, we very much welcome the suggestion made regarding the “top down” approach whereby ESMA, possibly together with the European Systemic Risk Board (ESRB), would analyze relevant data on OTC derivatives to determine where further standardization efforts could be targeted. To allow insight into the process, ESMA should monitor and publish relevant statistics on the proportion of OTC derivatives that are CCP cleared on a regular basis. Industry-led initiatives should continue to complement legislation to achieve G20 commitments on central counterparty clearing for OTC derivatives.

2. Eligibility for mandatory clearing: During the development phase of clearing offerings for new classes of OTC derivatives products, CCPs will naturally be in close contact with its market participants. It is therefore not necessarily the case that an additional 6-month consultation period from ESMA would be needed to assess an obligation. It should be considered to introduce a shorter time period.

3. Access to CCPs:

<table>
<thead>
<tr>
<th>Do stakeholders agree that access from trading venues to CCPs clearing eligible contracts should be guaranteed?</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>DBG specific comments and responses to questions:</strong></td>
</tr>
</tbody>
</table>

The text of the consultation document reads: “A CCP that has been authorised to clear eligible derivative contracts would have the obligation to accept clearing such contracts on a non-discriminatory basis, regardless of the venue of execution.” A CCP authorized to clear eligible OTC derivatives contracts will grant access to those services based on Section 5. Participation Requirements. With regard to access from trading venues, CCPs should be able to decide on the basis of their risk management requirements whether to connect trading platforms to the services of the CCP for OTC derivatives clearing services. Unconditional access cannot be assumed possible given legal and technical complexities.

On this point we suggest alignment with the CPSS-IOSCO May 2010 consultative report on guidance for the application of the CPSS-IOSCO Recommendations for Central Counterparties to OTC derivatives. The report states the following: “In OTC derivatives markets, where trading could occur over multiple venues, it is important for a CCP to conduct a thorough and regular analysis of risks, costs and benefits from accepting and clearing trades that are executed or processed at different venues.”

---

**DBG suggestions to consultation text:**

In order to give full effect to the clearing obligation, market participants must have full access to a CCP according to a clearly defined legal principle of access:

A CCP that has been authorised to clear eligible OTC derivative contracts would have the obligation to accept clearing of such contracts solely based on its risk management requirements, a non-discriminatory basis, regardless of the venue of execution. In OTC derivatives markets, where trading could occur over multiple venues, it is important for a CCP to conduct an analysis of risks, costs and benefits from accepting and clearing trades that are executed or processed at different venues before accepting trades from such venues.

A CCP authorized to clear eligible OTC derivatives contracts shall grant access to those services based on section 5. Participation Requirements.

---

**4. Non-financial counterparties:**

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

DBG specific comments and responses to questions:

Although the concrete definition of the proposed clearing thresholds remains open, the general concept of relying on OTC derivatives thresholds for non-financial counterparties as described appears appropriate. An understanding of the OTC derivatives business conducted by non-financials can be developed through evaluation of data provided by trade repositories on risk exposures. To this end, even if a non-financial counterparty is excluded from the clearing obligation, such transactions should nevertheless be reported to trade repositories so that regulators and supervisors can obtain a full picture of market risks.

It should be recognized that it is often the case that a financial entity is the counterparty to the non-financial entity. If such transactions are, according to thresholds, excluded from a clearing requirement, the overall impact of the legislation in controlling systemic risk is reduced.

Furthermore, it should be ensured that loopholes are not opened through the proposed exemptions, e.g. possibly through review processes built into the legislation.

---

**5. Risk mitigation for bilateral OTC derivative contracts:**

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

DBG specific comments and responses to questions:

We agree that risk management requirements for bilateral OTC derivatives contracts that cannot be CCP cleared should be established. Regarding point a), we believe the requirement for electronic means to ensure effective confirmation of the terms of the contract should not be qualified with the term “to the extent possible” as it substantially reduces the effectiveness of the measure.
If an OTC derivatives product (group) is not subject to the clearing requirement for financial entities or does not meet the threshold set for non-financial entities, such products should be subject to risk mitigation requirements, such as correspondingly higher capital requirements / bilateral collateral requirements reflecting the higher risks implied. The higher risks will be the result, for example, of difficulties associated with determining reasonable valuation price on a daily basis, which would be a sound benchmark in case of liquidation. As a result of appropriately managed risks for bilaterally handled OTC derivatives, use of CCP clearing will be incentivized, thereby increasing the proportion of OTC derivatives that are CCP cleared and reducing the scenario that bespoke derivatives are used when an appropriate clearable OTC derivative is available. It would be beneficial if this aspect of the consultation could be addressed simultaneously through the forthcoming Derivatives and Market Infrastructure Legislation rather than separated into separate legislative processes.

DBG suggestions to consultation text:

Importantly, not all OTC derivative contracts will be eligible for mandatory clearing and there will remain a portion of bespoke contracts. In order to ensure that the market understands and mitigates the risks in these contracts, EU-legislation would need to include specific principles and requirements in this respect.

Financial counterparties and non-financial counterparties exceeding the clearing threshold (see section 4 above) that enter into an OTC derivative contract that is not cleared by a CCP would need to ensure that appropriate procedures and arrangements are in place to measure, monitor and mitigate the higher operational and credit risk. To mitigate the risks, higher capital requirements / collateral requirements shall apply. In particular, they would need to have in place:

(a) to the extent possible, electronic means ensuring the effective confirmation of the terms of the OTC derivative contract;
(b) robust, resilient and auditable processes to monitor, where appropriate, the value of outstanding OTC derivatives contracts, to reconcile portfolios, to manage the associated risk and to identify early and to resolve disputes between parties. The value of outstanding contracts must be measured on a mark-to-market basis. The risk management procedures must require timely and accurate exchange of collateral and appropriate and proportionate holding of capital.

II. 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.

Do stakeholders consider that possible conflicts of interests would justify specific rules on the ownership of CCPs? If so, which kind of rules?
DBG specific comments and responses to questions:

As an overall comment, we note that the requirements as laid out by the Commission should reference where these are similar or different to current CPSS-IOSCO and ESCB-CESR recommendations for CCPs.

1. Organizational requirements: Under point d), the consultation calls for “a clear separation between the reporting lines for risk management and those for the other operations of the CCP.”
   In this context, the legislative text would in our view benefit from a clear definition of what falls under the term “risk management” and what does not. Risk management comprises both position risk management and its collateralization in addition to other risks in conjunction with clearing including operational risk, market risk, and liquidity risk, among others.

   We are in favour of clearly separated lines of responsibility to segregate position risk management / clearing operations from sales activities and duties related to investment activities. We see benefit in grouping clearing operations and position risk management within one area of responsibility. Furthermore, we believe that Treasury back-office activities and other risk management tasks (like counterparty / credit risk management, operational risk management, company risk controlling, and credit (back-office) tasks) would fit in the same area of responsibilities as well.

   Furthermore, the requirements for “independence” as in the eighth bullet point (“at least one third, but no less than two, of its members are independent both from other board members and from clearing members”) needs to be precisely defined.

DBG suggestions to consultation text:

In line with existing requirement set out in EU financial services legislation the Commission services consider that a CCP should have robust governance arrangements, which include at least:

- a clear organisational structure;
- adequate policies and procedures;
- a business continuity policy and disaster recovery plan;
- a clear separation between the reporting lines for risk management / clearing operations and those for the other operations activities of the CCP like sales and marketing or investment activities;
- a remuneration policy which is consistent with and promotes sound and effective risk management and which does not create incentives to relax risk standards;
- information technology systems adequate to the complexity, variety and type of services and activities performed;
- the record keeping of all the records on the services and activity provided and all transactions it has processed;
- persons who effectively direct the business of a CCP (Executive Management) should be of sufficiently good repute and experience so as to ensure the sound and prudent management of the CCP. For the Non-Executive Board, at least one third, but no less than two, of its members shall be independent both from other board members and from clearing members;
The competent authority should be informed about the identity of the shareholders and it should refuse authorisation if, taking into account the need to ensure the sound and prudent management of a CCP, it is not satisfied as to the suitability of the shareholders that have qualifying holdings (the general procedure established in Directive 2007/44/EC should apply).  

2. Risk committee: We believe that the scope of the Risk Committee as described is too far reaching and opens up the potential for conflicts of interest that threaten the integrity of the CCP. Given the diverging interest between risk appetite and margin level from market participants, it should be ensured that CCPs as risk managers remain neutral and independent from the influence of risk-takers. As such, it should be clearly recognized that decision-making on risk management measures rests solely with the CCP management and oversight on risk management solely with regulators. The Committee should be seen strictly as a sounding board and advisory group for the Executive Management of the CCP.

- In the final legislative text, the advisory rather than decision-making function of the Risk Committee needs to be clearly specified. A Risk Committee can (but is not required to) advise the CCP management in material risk-related topics such as those described in the consultation document under point c1) by consolidating member and market views. The CCP management can decide against the advice of the Risk Committee at its own discretion.

- We also have specific suggestions regarding the setup of the Risk Committee. We believe the Committee should consist of an equal number of Clearing Members and clients of Clearing Members, as well as a smaller number of independent industry experts. We would suggest removing the requirement for participation of “independent administrators” as the terminology is unclear and the three categories of members we suggest above are sufficient.

- In case of a negative decision, we question the proposal in point d) to inform the competent authority of any decision by the CCP not to follow the advice of the Committee.

- Point c2) reads: “If the chairman of the risk committee determines that a member has an actual or potential conflict of interest on a particular matter then that member should not be entitled to receive any material relating to that matter.” This process needs to be redefined as it entrusts the Chairperson with too much power that could potentially be misused. An alternative is a decision by the entire Committee.

- Furthermore, the introductory statement in the consultation document section states: “In order to measure and manage its risk-taking activities, each CCP should have in place an internal risk committee.” It should be noted that a CCP focuses on risk management activities rather than risk-taking activities, and the Risk Committee will be concerned with providing advice concerning risk management activities of a CCP, as described in

\[\text{\textsuperscript{2}}\text{ The legislative details of such requirements will need to be consistent with those already enshrined in the Capital Requirements Directive 2006/48/EC and MiFID 2004/39/EC.}\]
c1). Furthermore, the Risk Committee functions similar to other market advisory groups rather than as a subgroup of a board. As mentioned already, we therefore do not see this as an “internal” committee but rather as an “external” one consisting of but not limited to (existing and potential) customers. We would suggest deleting the introductory text or rephrasing accordingly to avoid possible confusion.

DBG suggestions to consultation text:

In order to measure and manage advise on its risk-taking management activities, each CCP should have in place an external risk committee. This may also contribute to any disincentives arising from the structure of a user-owned CCP. The composition and functioning of the Risk Committee of a CCP should be subject to the following set of five important principles and requirements:

a) A mandatory establishment of a Risk Committee, composed of representatives of its clearing members, clients of clearing members and independent administrators and industry experts. The advice of the risk committee should be independent from any direct influence by the management of the CCP.

b) The mandate, the governance arrangements to ensure its independence, the operational procedures, the admission criteria and the election mechanism of the risk committee should be clearly defined. The governance arrangements would be publicly available. The risk committee shall elect its chairperson through regular election cycles and would at least determine that the risk committee is chaired by an independent administrator, reports directly to the board and holds regular meetings.

c) The risk committee shall act as a sounding board consolidating member and market views and would advise the Executive Management of a CCP or the Non-Executive Board on any arrangements that may impact the risk management of the CCP, such as, but not limited to, a change in its risk model, the default procedures, the parameters for accepting clearing members or the clearing of new classes of instruments. The advice of the risk committee on these topics is not compulsory for the Executive Management and would not be required for the daily operations of the CCP or in emergency situations. The associated risk oversight shall be in the responsibility of the competent national authority.

c) The members of the risk committee should be bound by confidentiality. If the chairman of the members of the risk committee determine that a member has an actual or potential conflict of interest on a particular matter then that member should not be entitled to receive any material relating to that matter.

d) A CCP would promptly inform the competent authority of any decision in which it decides not to follow the advice of the risk committee.

e) A CCP would allow the clients of clearing members to participate in the risk committee or alternatively, it should establish appropriate consultation mechanisms that ensure that their interests are adequately represented.
3. **Conflicts of interest:** As a fundamental principle the neutrality and independence of CCPs from Clearing Members should be ensured. This can be addressed through governance arrangements including measures included under Organizational Requirements (board arrangements, clear reporting for risk management functions) and Risk Committees above. The ESCB-CESR Recommendations as published in May 2009 provide useful guidance in this regard (where conflicts of interest are addressed specifically under recommendations on governance and default procedures). The additional documentation and procedures requested in this section of the consultation document without clarity on the desired outcome / context would possibly generate significant burden without achieving the desired outcome.

4. **Outsourcing:** The text provided in points a) and b) appears reasonable but does not align fully with the introduction to the section. While a) and b) provide conditions that a CCP must meet when it outsources operational functions or any services or activities, the introductory text appears to aim to prohibit certain outsourcing altogether. Furthermore, the terminology used in the introductory statements is vague (in particular the reference “third parties” which would require a concrete definition), while the text in points a) – c) is clearer. We would suggest deleting the introduction while retaining the text in points a) – c).

5. **Participation requirements:** The proposed measures described appear reasonable, but we have two specific comments:

- Point c) reads: “... A CCP should be informed by its clearing members about the criteria and arrangements they adopt to allow their clients to access the services of the CCP.” As the CCP’s legal relationship is with its Clearing Members and not with the clients of Clearing Members, it should be clarified that the information provided is an information right and does not imply any obligation or liability for the CCP. Oversight on Clearing Members should rest solely with the competent authorities, i.e. bank regulators.

- Overall, it should be ensured that the relationship between Clearing Members and clients of Clearing Members is the responsibility of bank regulators and not CCPs.

**DBG suggestions to consultation text:**

The following six clearly defined principles and requirements would also contribute in an important manner to an appropriately transparent and indiscriminate functioning of a CCP. These requirements would also meet concerns that may arise in view of the ownership structure of a CCP:

a) **A CCP should establish the categories of admissible clearing members and the admission criteria.** These criteria should be non-discriminatory, transparent and objective so as to ensure fair and open access to the CCP and should ensure that clearing members have sufficient financial resources and operational capacity to meet the obligations arising from participation in a CCP. Criteria that restrict access should only be permitted to the extent that their objective is to control the risk for the CCP.

b) **A CCP should ensure that the application of the criteria referred to in paragraph a) is met on an on-going basis and shall have timely access to the information relevant for the**
assessment. A CCP should conduct, at least once a year, a comprehensive review of the compliance with these provisions by its clearing members.

c) Clearing members that clear transactions on behalf of their clients should have the necessary additional financial resources and operational capacity to perform this activity. A CCP should be informed by its clearing members about the criteria and arrangements they adopt to allow their clients to access the services of the CCP. The responsibility for monitoring and supervision as well as any obligations or liabilities of the clients remain with their clearing member.

d) A CCP should have objective and transparent procedures for the suspension and orderly exit of clearing members that no longer meet the criteria referred to in paragraph a).

e) A CCP should only deny access to clearing members meeting the criteria referred to in paragraph a), if it is duly justified in writing and based on a comprehensive risk analysis.

f) A CCP may impose specific additional obligations on clearing members, such as, but not limited to, the participation in auctions of a defaulting clearing member's position. These additional obligations should be proportional to the risk brought by the clearing member and should not restrict participation to certain categories of clearing members.

6. Transparency: Point b) needs to be further specified in the legislative text as it currently is too open to interpretation and could expose a CCP to significant liability risk if a Clearing Member that loses money claims that a CCP failed to disclose specific risks. For example, the text should state exactly which risks should be considered, including for example, the possibility of member default, risks associated with the individual product, others.

CCP ownership: Possible conflicts associated with different forms of ownership can best be addressed via appropriate governance frameworks. In the case of user-owned CCPs, such frameworks would ensure a certain level of independence of the CCP from its customers to avoid, for example, a situation where a shareholder Clearing Member takes high risks (or relaxes risk management requirements) which it is able to mutualise to other Clearing Members or where shareholder Clearing Members limit development of CCP services to protect own revenue sources, among others. As described above under the section on Risk Committees, it should be ensured that CCPs as risk managers remain neutral and independent from the influence of risk-taking entities. This can be facilitated through appropriately structured governance arrangements (addressed under Operational Requirements above) and Risk Committees.

7. Segregation and portability:

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

DBG specific comments and responses to questions:

We welcome the approach presented on segregation and portability and believe that the use of segregation mechanisms plays an important role in protecting clients from the default of a Clearing Member. Greater transparency and legal certainty about the treatment of client positions and assets in case of a Clearing Member default are a critical success factor in achieving a sustainable segregation solution. Allowing choice of different segregation mechanisms and setting
incentives (in terms of reduced capital requirements) for clients to use individual, gross or net omnibus segregation solutions will allow clients and Clearing Members to agree on an appropriate setup that satisfies the risk-/cost-profile of clients.

Especially the principle e) is welcome to clearly ensure a right for CCPs to provide segregation solutions irrespective of national laws. Given fragmented national insolvency regimes a harmonized EU law on this issue is required to provide for an EU-wide level playing field and legal certainty for the relationships between CCPs, Clearing Members and clients. This legislation should provide certainty and clear guidance for Level 2 regulation that actions taken by the CCP as part of its default procedures and as part of the segregation procedures to implement principles a) - d) are enforceable and that such actions may not later be stayed, avoided, or reversed.

More specifically, we have the following suggestions:

- CCPs should retain the ability to offer different segregation mechanisms to allow clients the choice of segregation. The legislative text should allow the CCPs to decide which segregation solutions he wants to offer. This appears to be reflected in the current wording of the consultation document.

- Clearing Members and clients of Clearing Members should be allowed to decide which segregation solution should be used, taking into account the risk-/cost-profile of the client and the client’s evaluation of the counterparty risk involved. There should be no mandatory requirement to pass through client assets (i.e. client collaterals) to the CCP. This appears to be reflected in the current wording of the consultation document.

- We strongly agree with the requirement for the segregation of positions, i.e. a clear separation between proprietary positions of the Clearing Member and positions of clients of the Clearing Members. This is necessary for the CCP in order to offer segregation solutions. This appears to be reflected in the current wording of the consultation document.

- In the final legislative text (or in the technical guidance to be developed by ESMA), the term “segregation” needs to be defined more precisely, taking into account that the definition should not be as narrow as in the case of “segregation that needs to be provided by investment firms.” The legislative text needs to take into account the specifics of a CCP. The definition should define which “assets” are to be segregated. We assume that client collateral (securities or cash) and the daily payment from and to the client (e.g. premiums, variation margin, and cash settlements) should be segregated. Cash flows that are involved in delivery-versus-payment transactions should not be segregated to allow for safety and efficiency in the delivery process. To retain safety and efficiency in today’s payment processes cash payment of segregated clients on Clearing Member level should be treated as a whole (i.e. netted, no payment or delivery instructions per individual segregated clients are necessary). Cash flows that are involved in delivery-versus-payment transactions should not be segregated to allow for safety and efficiency in the delivery process. We believe this can be addressed via Level 2 guidance to be developed by ESMA.

- The CCP can only ensure segregation and portability for institutional clients of the Clearing Member. It is not appropriate that private end-clients are part of the definition in the legislative text. To ensure portability of private end clients, the CCP would become like a
“super-bank” which has to register hundreds of thousand accounts. If it is required to provide for segregation / portability of assets of private end clients, then a national authority needs to be involved in the transfer process (for example BaFin in Germany or the FDIC in the US). We believe this can be addressed via Level 2 guidance to be developed by ESMA.

- Depending on the level of segregation chosen by the client and only as long as the CCP’s integrity and safety is not at risk the transfer process can be supported (this might require the involvement of an administrator especially in the case of a potential omnibus model). If the risk situation of the CCP becomes too critical, or if the client does not find a new clearing firm, then the CCP must be allowed to close out client positions and to realize the relevant collateral. Please find suggested text on this point below.

- It should be clarified that the zero exposure value is secured for the client (which has the adequate segregation level), which from our point is not clear from the current wording. Please find suggested text on this point below.

**DBG suggestions to consultation text:**

A key lesson from the financial crisis has been the need to have greater transparency and legal certainty about the rules and requirements surrounding the segregation of assets and positions within CCPs and its clearing members. Cash flows that are involved in delivery-versus-payment transactions should not be segregated. The following 5 clear principles and obligations would introduce much-needed improvement in this area:

- **a)** A CCP should keep records and accounts that shall enable it, at any time and without delay, to identify and segregate the assets and positions of one clearing member from the assets and positions of any other clearing member and from its own assets. **CCPs may offer different segregation mechanisms to allow clients the choice of segregation.**

- **b)** A CCP should require each clearing member to distinguish and segregate in accounts with the CCP the assets and positions of that clearing member from those of its clients. A clearing member should allow its clients to have a more detailed segregation of its assets and positions. The CCP should publicly disclose the risks and costs associated with the different levels of segregation.

- **c)** On the basis of the level of segregation chosen by a client, the **rules of the CCP should ensure that it is able to transfer on request at a pre-defined trigger event or liquidate in case a transfer was not possible, without the consent of the clearing member and within a pre-defined transfer period its assets and positions to another clearing member, provided that the integrity of the CCP and the safety of its participants is not compromised and the transfer process can be supported (this might require the involvement of an administrator especially in the case of a potential omnibus model). In case the risk situation for the CCP becomes too critical, or if no other clearing member is willing to take the client positions, then the CCP must be allowed to close out client positions and to realize the relevant collateral. The latter should not be obliged to accept those assets and positions, unless it has entered into a previous contractual relationship in that respect. The rules shall identify the circumstances under which positions may be liquidated or transferred, which
positions are eligible for liquidation or transfer, who may exercise this authority, and what are the applicable time frames within which actions would be taken.

d) Provided that the counterparty credit risk rules (‘0 exposure value) of the Capital Requirements Directive should apply to clients that are not exposed to the default of the clearing member through which it has access to the CCP or of any other clients.

e) The requirements under this heading should prevail over any conflicting laws, regulations and administrative provisions of the Member States that prevent the parties from fulfilling them.

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? Should the default fund be mandatory and what risks should it cover? Should the rank of the different lines of defense 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?

DBG specific comments and responses to questions:

As a general comment, we point out that a banking license for CCPs is currently required in two countries (France and Germany). The consultation document, however, does not cover introduction of a harmonized regulatory status either as a bank or a special CCP license. Currently, regulatory requirements for recognition as a CCP in Europe are not consistent and the consultation document does not address this topic. To provide for a level playing field and to avoid competition based on / threatening risk standards, a harmonized status as “special purpose bank” should be introduced with this legislation for all EU CCPs. This will also serve to clarify regulatory responsibilities.

A. Initial Capital / What should be the adequate level of initial capital?: We suggest basing the value of the initial capital on the requirement for credit institutions under the Banking Directive (2006/48/EC). This is €5 million as a minimum (scaled up in the case of larger CCPs according to relevant criteria with, for example, medium size = €25 million, large size = €75 million) and, in addition, the application of the full Basel II rules to cover operational, market, and counterparty risk (for example arising from the placement of own funds and cash collaterals) for solvency purposes. For the purposes of the “Basel II” rules the CCP positions need to be explicitly neutralized as they are covered by the default waterfall.

Initial capital should be defined to comprise capital and paid-in reserves. Furthermore, it should be clarified in the legislative text that initial capital should not be used to cover any transaction-

related risks, as these are covered through the “default waterfall” or “lines of defence,” for example through margins and the clearing fund. The wording “orderly wind-down” in b) is misleading in this context as it may be interpreted to refer to a wind-down of positions.

DBG suggestions to consultation text:

a) Based on the requirements of credit institutions a CCP should have a permanent, available and separate initial capital of at least EUR \[X\] million. For medium-sized CCPs, the initial capital should be EUR 25 million, and for larger CCPs EUR 75 million.

b) For solvency purposes the full Basel II rules shall apply to cover operational, market, and counterparty risk (for example arising from the placement of own funds and cash collaterals).

c) Initial capital should comprise capital and paid-in reserves and shall not be used to cover any transaction-related risks, as these are covered through the “default waterfall” or “other risk controls”. The initial capital shall at all times be sufficient to ensure that it allows for an orderly wind-down liquidation of the CCP or restructuring of the activities over an appropriate time span and that the CCP is adequately covered against operational and residual risks.

B. Exposure Management / Are exposures of CCPs appropriately measured and managed?:
The overall concept appears correct and acknowledges that for some products a real-time assessment can be performed while in other cases intra-day calculations are made but not in real time.

C. Margin Requirements:

- Point a) groups together collection of margin from Clearing Members with collection of margin from linked CCPs: “A CCP should impose, call and collect margins to limit its credit exposures from its clearing members, and where relevant, from CCPs which have interoperable arrangements.” We believe this treatment is an over-simplification: It should be recognized that there would be significant differences in margin collection from Clearing Members versus from linked CCPs due to different risk profiles and even within CCPs since procedures and eligible collaterals differ across CCPs. Further, cross-CCP risk exposure should be margined according to the cross-CCP risk model and by appropriate collaterals. A CCP should be able to decide individually whether own collateral or Clearing Members’ collateral should be used to cover cross-CCP risk exposure.

- Point d) calls for segregation of margins posted by each Clearing Member. This should be further specified. Segregation in a sense of identifying and record-keeping of margin collateral is acceptable. In this case, the CCP would segregate the cash and securities collaterals within its books. Segregation in a sense comparable to MiFID requirements that apply to Investment Firms, which would call for a full segregation of (cash) accounts, would be lead to a reduction of safety given that some clients would not have access to central bank accounts which would imply that commercial bank accounts would have to be used. In order to address concerns regarding use of margins posted by Clearing Members, the order of default waterfall / lines of defense should be specified.
DBG suggestions to consultation text:

a) A CCP should impose, call and collect margins to limit its credit exposures from its clearing members, and where relevant, from CCPs which have interoperable arrangements. These margins should be sufficient to cover potential exposures that the CCP estimates will occur until the liquidation of the relevant positions. They should be sufficient to cover losses that result from at least 99 per cent of the price movements over an appropriate time horizon and they should ensure that a CCP fully collateralises its exposures with all its clearing members, and where relevant, CCPs which have interoperable arrangements at least on a daily basis.

b) A CCP should adopt models and parameters in setting its margin requirements that capture the risk characteristics of the products cleared and take into account the interval between margin collections, market liquidity and the possibility of changes over the duration of the transaction. The models and parameters should be validated by the competent authority.

c) A CCP should call and collect margins on an intraday basis, at minimum when pre-defined thresholds are breached.

d) A CCP should segregate the margins posted by each clearing member in its books for record keeping and identification purposes, and, where relevant, by CCPs that have interoperable arrangements and should ensure the protection of the margins posted against the default of other clearing members, the institution where they are deposited, or of the CCP itself and from any other loss the CCP may experience.

D. Default Fund / Should the default fund be mandatory and what risks should it cover?:

We believe that a Default Fund should be mandatory to avoid a race to the bottom in risk management and to ensure that Clearing Members, through their own contribution to the Fund, have an incentive and commitment to appropriate management of risk. All market- and member-related risks should be covered by the Default Fund, including any risks due to linked clearinghouses. Only operations-related CCP defaults should be excluded (as they are covered by the initial capital).

Point b) outlining the coverage of the Default Fund should apply to each Default Fund separately in case of a CCP with multiple Default Funds. Accordingly, point c), should state clearly that the rules under b) are valid for each Default Fund independently.

DBG suggestions to consultation text:

a) A CCP should **must** maintain a default fund to cover losses arising from **all market and member related risks** the default, including the opening of an insolvency procedure (default), of one or more clearing members. The clearing fund should not cover operations related CCP defaults.

b) A CCP should establish the minimum size of contributions to the default fund and the criteria to calculate the contributions of the single clearing members. The contributions should be proportional to the exposures of each clearing member and should take into account the requirements under "other risk controls", in order to ensure that the contributions to the default fund at least enable the CCP to withstand the default of the clearing member to which it has the largest exposures or of the second and third largest clearing members, if the sum of their exposures is larger.
c) These provisions under b) should not prevent a CCP to establish more than one default fund for the different classes of instruments it clears and should be applied to each default fund independently.

E. Other Risk Controls: Point a) refers to further funds available in the case of potential losses, beyond margin requirements and Default Fund. We would suggest that reference to “any other clearing fund” be deleted as it is unclear what this could be and how it would differ from a Default Fund. If a reference to this separate “clearing fund” is to remain, it must be specified what the fund is and how it differs from the Default Fund.

In commercial and corporate law, the own funds of a CCP will always be taken into account to cover operating losses. Therefore the requirement that own funds of a CCP “should not be used to cover the operating losses” is unclear to us. We propose to give the CCP the possibility to dedicate certain parts of own funds as being not intended to cover the operating losses in the course of the default waterfall. In order to demonstrate that this part is not intended to be used for “Basel II” solvency purposes, it must be deducted from own funds for the calculation of the solvency ratio.

Furthermore, there is no clear guidance given under point a) on how “sufficient” will be measured. We therefore recommend to take out such a phrase in the final legislative document or to specify this. The rules given in point b) give an indication of what could be meant here.

Point b) requires further specification where it currently reads: “The default fund referred above and the other financial resources referred to in paragraph a) should at any time enable the CCP to withstand the default of the three clearing members to which it has the largest exposures.” It should be clarified that the additional available financial resources specified under a) should cover the default of the three Clearing Members to which the CCP has the largest exposures within each separate Default Fund. In this context, no element to cover these exposures should be double counted.

Point c) calls for a limitation of financing dependency towards single exposures to banks via credit lines. We agree to the concept in general, but strongly believe that a 10 percent threshold is too narrow. As practically all major banks are Clearing Members, this requirement would force a CCP to maintain credit lines with at least 10 banks. This is not practicable and would potentially harm the “quality” of the counterparties for our credit lines: Eurex Clearing currently maintains lines with high quality banks. If we were forced to diversify, we may need to contract with weaker banks, which, in case of a market crash, may be the first to withdraw their credit commitments. Furthermore, contracting with multiple banks would serve to increase costs substantially; particularly for smaller CCPs or for a minor currency of a larger CCP, the threshold would have significant cost implications. Some banks might not even be willing to provide lines with such a profile. We suggest using a threshold of at least 30 percent. In addition, the treatment of central bank lines / liquidity in this context needs to be specified, especially as this is proposed to be the preferred treatment.
DBG suggestions to consultation text:

a) In addition to the initial capital, a CCP should maintain sufficient available financial resources to cover potential losses that exceed the losses to be covered by margin requirements and the default fund. These resources may include any other clearing funds provided by clearing members or other parties, loss sharing arrangements, insurance arrangements, the own funds of a CCP (excluding initial capital), parental guarantees or similar provisions. These financial resources should be freely available to the CCP and should not be used to cover the operating losses and should be clearly dedicated for that purpose.

b) A CCP should develop scenarios of extreme but plausible market conditions, which include the most volatile periods that have been experienced by the markets for which the CCP provides its services. The default fund referred above and the other financial resources referred to in paragraph a) should at any time enable the CCP to withstand the default of the three clearing members to which it has the largest exposures within each separate default fund and should enable the CCP to withstand sudden sales of financial resources and rapid reductions in market liquidity.

c) A CCP should obtain the necessary credit lines or similar arrangements to cover its liquidity needs in case the financial resources at its disposal are not immediately available. Each clearing member, parent undertaking or subsidiary of the clearing member should not be able to provide more than 40% of the credit lines needed by the CCP.

d) A CCP may require non-defaulting clearing members to provide additional funds in the event of a default of another clearing member. The clearing members of a CCP should have limited exposures toward the CCP.

F. Default waterfall / Should the rank of the different lines of defence of a CCP be specified:

We believe the rank of the different lines of defence of a CCP should be specified according to the Commission proposal, accounting for comments below.

Under point b), it needs to be clarified, how to process in case a Clearing Member defaults under the rules of the CCP in one market (but not in others) and how to proceed with the margins / Default Fund contributions for other markets. We suggest that as one entity will always default across the full set of CCP relationships, the CCP should have the right to use the full contributions of a defaulted member across all clearing house relationships / licenses. Otherwise there might be the risk that, for one relationship, Default Fund contributions are returned and there is a shortfall on another relationship / license and the overall member default fund would have to be used.

Under point c), it needs to be clarified that the “own funds” referenced are dedicated “own funds” only (see our comment above).

Regarding the order of the lines of defence, the following approach is most appropriate:

a. Margins of defaulting Clearing Member (as in point a) of the consultation document);

b. Default Fund contribution of defaulting Clearing Member (as in point b) of the consultation document);

c. Default Fund contributions of non-defaulting Clearing Members;
d. Additional funds as described under Ea) other Risk Controls above. (Remark: We do not propose to have any pre-defined rank within Ea), the final layer of the waterfall. The appropriate order within this rank should be left to the discretion of each CCP. Furthermore, it should be left to the discretion of the CCP to add further elements to the waterfall ranked after any part of the Default Fund. Such items could be the initial capital or any other part of the own funds not dedicated to the “other Risk Controls”)

DBG suggestions to consultation text:

a) A CCP should use the margins of a defaulting clearing member prior to other financial resources in covering losses.

b) If the margins of the defaulting clearing member are not sufficient to cover the losses incurred by the CCP, the CCP should use the default fund contribution of the defaulting member to cover these losses.

c) A CCP should use the default fund contributions to the default fund of the other clearing members and other contributions of non-defaulting clearing members followed by, where relevant, the CCP’s own funds referred to under other risk controls, additional funds as described under E a) “other risk controls”. The appropriate order within this final rank should be left to the discretion of each CCP.

d) A CCP should not be allowed to use the margins posted by non-defaulting clearing members to cover the losses resulting from the default of another clearing member.

G. Collateral Requirements / Will the collateral requirements ensure that CCPs will not be exposed to external risks?: The requirement seems to be appropriate and will contribute to reducing risk substantially, although clearly it cannot eliminate risks completely. We note however that further guidance regarding a confidence level for the haircuts could be mentioned in the text.

H. Investment Policy / Will the investment policy ensure that CCPs will not be exposed to external risks?: The investment policy cannot ensure that the CCP will not be exposed to external risk, but the requirement seems to be appropriate and reduces risk to the lowest level feasible. Nevertheless, the investment policy guidelines should include a requirement to collateralise exposures towards commercial banks with high quality securities to the greatest extent possible. It should be noted however, that a mandatory full collateralisation might not be possible under certain market conditions.

A few specific comments include:

• Point b) refers to required non-discriminatory access of the CCP to the securities settlement system (SSS). A CCP cannot be responsible for ensuring that the SSS provides non-discriminatory access to CCPs. The legislation should not prohibit CCPs from continuing to deposit with SSSs with which it currently has relationships, even if those SSSs are unable to demonstrate non-discriminatory access to CCPs.

• Point b) should be reworded from “financial instruments” to “financial instruments other than cash.”
• Under point c), the reference to “requirements above” should be specified.

• Point e) calls for CCPs to deposit liquidity with central banks whenever possible. While we support in general the use of central bank money, we disagree with the proposed obligation and would suggest this to be reworded to be an access right for CCPs to central bank interest-bearing facilities. Paragraphs a) to d) are designed to protect cash margins. A requirement to deposit all cash with the central bank is:
  
  o Not in the interests of the Clearing Members: Since the cash collateral would receive lower interest income compared to reasonable secure placements with commercial banks (mainly on a secured basis), Clearing Members might shift from cash to securities collateral. For a CCP, cash collateral is preferred as it does not have market risks (other than currency risk if relevant) and is highly liquid.
  
  o Likely not in the interests of central banks: In the case of mandatory use, cash amounts would be withdrawn from the inter-bank market which in turn would force banks to lend to a larger extent from central banks. The central bank function of a “lender of last resort” would be switched in this case to a “lender of general usage.”

DBG suggestions to consultation text:

a) A CCP should only invest its financial resources in highly liquid financial instruments with minimal market and credit risk. The investments should be capable of being liquidated rapidly with minimal adverse price effect.

b) Financial instruments other than cash posted as margins should be deposited with operators of securities settlement system that ensure non discriminatory access to CCPs and the full protection of those instruments. A CCP should have prompt access to the financial instruments when required.

c) A CCP should not invest its capital or the sums arising from the requirements above (requirements need to be specified) in its own securities or those of its parent undertaking.

d) A CCP should take into account its overall credit risk exposures to individual obligors in making its investment decision and should ensure that its overall risk exposure to any individual obligor remains within acceptable concentration limits.

e) Whenever allowed, in cases where a CCP has access to interest-bearing facilities of the relevant central bank, a CCP should deposit the liquidity collected from its clearing members and necessary to ensure its normal functioning with the central banks of issue.

I. Default procedures: With regard to point d), the text of the consultation document suggests that the legal jurisdiction of the country of location of the Clearing Member has to be taken into account in case of a default irrespective of location of the CCP. This creates legal uncertainty about applicable law. Ideally, legal enforceability of default procedures can be achieved in line with section 7. Segregation and Portability point e) which clarifies that, as it applies to segregation and portability, the regulation will prevail over national law. Therefore we would recommend rewording point d) to avoid ambiguity and possible inconsistencies with the Settlement Finality Directive and delete the reference to national insolvency laws (please find our
Relevant national law should permit that a CCP may close out Clearing Members’ proprietary positions as well as Clearing Members’ client positions which could not be transferred. The close out of open position via the exchange or over-the-counter is the appropriate process to ensure market integrity and to prevent that the CCP and potentially also non-defaulting Clearing Members are exposed to severe market movements. In contrast, mandatory termination and cash settlement of open positions as foreseen by some European insolvency laws can have an adverse impact on the financial markets any might cause domino effects because of a “fire-sale approach” that cannot consider the relevant market situation.

Further, to enable CCPs to implement enforceable default procedures across Europe, the protection granted to CCPs via the Settlement Finality Directive should be expanded to provide that:

- Default procedures of CCPs are not only enforceable vis-à-vis direct participants (Clearing Members) but also vis-à-vis indirect participants (clients of Clearing Members). This is necessary to allow for transfer of client positions and collaterals.

- The protection granted currently by the Settlement Finality Directive is only applicable when the insolvency case is opened. For earlier trigger events, the CCP can be exposed to the various national jurisdictions of its clearing members. Here, consideration of additional trigger events is suggested.

**DBG suggestions to consultation text:**

a) A CCP should have procedures in place in the event a clearing member does not comply with the requirements laid down in this chapter within the time and according to the procedures established by the CCP. The CCP should outline the procedures to be followed in the event the insolvency of a clearing member in case the default is not established by the CCP.

b) A CCP should take prompt action to contain losses and liquidity pressures resulting from defaults and should ensure that the closing out of any clearing member's positions does not disrupt its operations or expose the non-defaulting clearing members to losses that they cannot anticipate or control.

c) The CCP should promptly inform the competent authority and the latter should immediately inform the authority responsible for the supervision of the defaulting clearing member if it considers that the clearing member will not be able to meet its future obligations and when it intends to declare its default.

d) A CCP should establish that its default procedures are legally enforceable taking into account the national insolvency laws applicable to the defaulting towards its clearing members. It should take all the reasonable steps to ensure and that it has the legal powers to liquidate the proprietary positions of the defaulting clearing member and to transfer or liquidate the client's positions of the defaulting clearing member.
J. Review of models, stress testing and back testing:

- Point a) requires that a “CCP should inform the competent authority of the results of the tests performed and should obtain its validation before adopting any change to the models and parameters.” This requirement does not afford the CCP the required flexibility to adopt changes as required. We would suggest rewording to: “a CCP should inform the competent authority of the results of the tests performed as well as any significant resulting changes to the models and parameters.”

- Point b) requires that “a CCP should regularly test the key aspects of its default procedures and take all reasonable steps to ensure that all clearing members understand them….” The term “all reasonable steps” is vague. We would recommend rephrasing to “a CCP should regularly test the key aspects of its default procedures and inform clearing members accordingly.”

DBG suggestions to consultation text:

a) A CCP should regularly review the models and parameters adopted to calculate its margin requirements, default fund contributions, collateral requirements and other risk control mechanisms. It should subject the models to rigorous and frequent stress tests to assess their resilience in extreme but plausible market conditions and should perform back tests to assess the reliability of the methodology adopted. The CCP should inform the competent authority of the results of the tests performed and should obtain its validation before adopting as well as any significant resulting changes to the models and parameters.

b) A CCP should regularly test the key aspects of its default procedures and take inform all the reasonable steps to ensure that all clearing members accordingly understand them and have appropriate arrangements in place to respond to a default event.

K. Settlement Risk: Point a) reads: “A CCP should, when available, use central bank money to settle its transactions.” We support use of central bank money for settlement purposes / cash operations wherever possible. This implies that access to central bank credit (not just intra-day credit) facilities as well as interest-bearing deposit facilities would need to be ensured, at least in all European markets. There are, however, some limitations to the use of central bank money:

- Some CSDs might require commercial bank money for some assets even in areas where alternative settlement at different venues would be possible.

- Use of commercial bank money must still be possible for late payments and payments in foreign currencies.

Particularly with regard to point c), we would note that the possibility to use securities lending in favour of clients in order to prevent settlement fails should be included.
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?

DBG specific comments and responses to questions:

9. Relations with third countries: In order to accept eligible contracts to clear, a CCP should be located and supervised in the EU. This is important to ensure that strong prudential standards for CCP risk management are not compromised. For the trade repository / post-trade transparency functions of CCPs, it also ensures EU regulator and supervisor access to necessary data in all situations and increases legal and regulatory certainty, ensuring risk mitigation, data quality, and transparency objectives are fulfilled.

Furthermore, it is important to note that margin and default fund contributions in the form of cash collateral, given its liquidity, is the preferred choice. As Clearing Members within the European Economic Area fall in most cases within the scope of the Capital Requirements Directive, the deposited cash collateral towards the CCP in principle would fall within the scope of the large exposure rules. Especially for late margin calls, there is no other option to deliver cash. We therefore wish to raise the point that cash collateral provided to a CCP should be exempt for the exposure definition and therefore an exemption for this should be inserted in article 106 (2) of the directive 2006/48/EC in order to complement the exemption with regard to certain client (non-proprietary) positions in lit c. of that regulation. (See also expected final CEBS guidelines on the implementation of the new articles 106 (2) lit c and d of CRD II).

III. Interoperability

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

DBG specific comments and responses to questions:

We believe that the Commission should focus on the implementation of the G20 mandate on sustaining market stability and integrity through CCP clearing (as well as exchange trading and registration) of OTC derivatives and leave interoperability for cash equities out of this legislative proposal. The issue of interoperability for cash equities requires a separate debate and an appropriate impact assessment.

More specifically, we believe that mandating interoperability for cash equities not only distracts from the required policy agenda, but in fact works against the aims of increasing market integrity and stability, while also reducing market efficiency. National regulators have accordingly already raised their concerns on interoperability. It increases systemic risk and brings additional unwanted costs to the market.
Deutsche Börse Group comments on European Commission “Public Consultation on Derivatives and Market Infrastructure” 8 July 2010

We highlight the following:

- **Prevent “race to the bottom” in risk and legal aspects.** Mandating interoperability between clearinghouses should be avoided as it would foster competition on grounds of risk methodology, collateral regulations, and jurisdiction. As a result, a “race to the bottom” in risk and legal aspects may ensue, impairing the CCPs’ ability to successfully manage risks and questioning their underlying purpose.

- **Avoid creating additional systemic risk and reducing market efficiency.** Systemic risks would grow disproportionately with the number of clearinghouses becoming interoperable, as the number of bilateral links required to connect them increases rapidly. Open risk positions could potentially be linked across multiple jurisdictions and regulators with unpredictable consequences in case of a market default. Consequences would be especially severe in the derivatives arena due to long settlement periods, frequently extending for several years. Especially derivatives CCPs will not be “balanced”, thus increasing exposure to one-sided market movements and resulting in a higher likelihood of default. In addition, the efficiency of post-trade structures would be harmed through the establishment of links not needed by the market. New links require additional collateral, implying rising cost for market participants (see AFM, DNB, FINMA, FSA, SNB, Communication of Regulatory Position on Interoperability, February 2010).

- **Efficiency improvements in clearing achieved and cross-border barriers removed.** Efficiency in European clearing has been improving and continues to do so, making additional regulation targeted at efficiency unnecessary. In 6 out of 7 markets, prices in European equity clearing decreased by 20-60% between 2006 and 2008 (see Oxera, Monitoring prices, costs and volumes of trading and post-trading services, 16 July 2009). In 2009 and Q2 2010, further price reductions of CCPs have been implemented. Competitive forces at play will continue to drive European CCPs to create further efficiencies. Cross-border barriers have been successfully removed and pan-European offerings were established with significant market share in trading and clearing.

- **Avoid further market fragmentation and ensure effective price discovery.** Interoperability could potentially exacerbate currently observed negative effects on price discovery through further fragmentation of liquidity. Problems associated with fragmentation were clearly underlined in the May 2010 market crash in the US. Fragmentation among CCPs would create risks that are exponentially worse.

- **Maintain operational control at the trading layer.** A legal mandate for CCP interoperability contradicts the need of trading platforms to sufficiently control their trade flow and post-trade structure. Multiple interfaces between independent entities will put end-to-end operational stability at risk as well as it will complicate and reduce incentives for product innovation on the trading layer.
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.

DBG specific comments and responses to questions:

For OTC derivatives that are cleared by a CCP, the CCP provides the function of a data repository and there should be no additional requirement either on counterparties to report contracts to a repository, or for the CCP to report positions to a repository.

Trade repositories provide an important risk mitigation function for non-cleared contracts, underpinning the quality of information available for regulatory / supervisory functions. Market-led solutions should be fostered to allow market participants choice and encourage innovation. CCPs serve as trade repositories for CCP-cleared transactions as they gather and provide the relevant information. As stated, regulators / supervisors—together with trade repositories, CCPs, and exchanges—will be responsible for defining technical standards for reporting such that data from multiple sources can be consolidated by regulators / supervisors. As a minimum these should also ensure identification of reporting parties for a given contract, whether the contract has been bilaterally confirmed, (i.e. by the Clearing identifier or trade repository identifier) and what its confirmation status is following any subsequent modification. These standards are key to accessing and compiling the multiple sources of information required at a regulatory/supervisory level.

EU location of trade repositories is important to ensure EU regulator / supervisor access to necessary data in all situations and can increase legal and regulatory certainty, ensuring the risk mitigation, and data quality, and transparency objectives of trade repositories are fulfilled.

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?

DBG specific comments and responses to questions:

We share the general approach with regard to the proposed high-level requirements. However, a detailed assessment would only be possible once the requirements are further specified.

Furthermore, we note that the requirements will be fulfilled by CCPs as well for CCP-cleared transactions. This approach is in line with the proposal in the CPSS-IOSCO consultative report on considerations for trade repositories in OTC derivatives markets: “other types of market infrastructures or service providers that centrally maintain market-wide OTC derivatives trade information (e.g. CCPs) should also be expected to consider these factors for their respective record keeping functions” for aspects of the trade repository functions that do not fall under other recommendations.  

---

II. Closing

On the cover of the consultation document, it is noted that: “this document is a working document of the Internal Market and Services Directorate General of the European Commission for discussion and consultation purposes. It does not purport to represent or pre-judge the formal proposal of the Commission.” As noted already, we find this consultation an important step in the legislative process and would also welcome being able to provide comments as proposals become more concrete and legislative wording is drafted.

We hope that you have found these comments useful and remain at your disposal for further discussion. If you have any questions please do not hesitate to contact:

**Thomas Book**
Member of the Executive Board
Eurex Frankfurt AG
Thomas.Book @ eurexchange.com

**Stefan Mai**
Head of Section, Market Policy and European Public Affairs
Deutsche Börse AG
Stefan.Mai @ deutsche-boerse.com