Bank for International Settlements
Committee on Payment and Settlement Systems (CPSS)

International Organisation of Securities Commissions (IOSCO)
Technical Committee

- submitted via e-mail to cpss@bis.org and CCP-OTC-Recommendations@iosco.org -

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EAPB comments on the consultative report "Guidance on the application of the 2004 CPSS-IOSCO Recommendations for Central Counterparties to OTC derivatives CCPs"

The European Association of Public Banks (EAPB) is thankful for the opportunity to comment on the above mentioned consultative report. Building efficient, safe and sound market infrastructures is of utmost importance, especially when further extending central clearing to the derivatives space. Central clearing for standardised derivatives contracts is an effective mean to limit the counterparty default risk. OTC derivatives markets are nonetheless very diverse. Applying uniform solutions for all products will not be possible without affecting the risk minimizing features of OTC derivatives. Derivative contracts must be eligible for central clearing. The criteria for this eligibility and for who determines this criteria remains unclear. A structured and regular dialogue between market infrastructures, users, and public policy officials is worthwhile and should fashion consensual regulatory solutions that reward open approaches and support their smooth implementation.

Remarks on specific guidance

Guidance 1.1:

Derivative transactions are entered on the basis of more than one type of standardised master agreement regarding documentation that governs the rights and obligations. Transactions of non-financial entities or between counterparties in one jurisdiction are often entered on the basis of a standardised national - and not international - master agreement documentation. OTC derivative transactions with the European Central Bank are made on the basis of the European Master Agreement.

Guidance 2.1 and 6.1:

Usually markets will be or will become stressed when a clearing member defaults. In times of stressed markets banks are in definite need of exactly the expertise they are expected to second. CCPs should be professionally-driven organisations and responsible for the quality

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of the service they provide to their clients and for the arrangement of the necessary resources to deliver that service. A smooth operation of the CCP is in the interest of banks who therefore will second experts as much as they can. A binding ex-ante agreement may prove counterproductive.

Recommendation 3:

If the potential difficulties for understanding potential risks and for the reliability of pricing that stem from the unique characteristics of OTC derivatives are too large for certain products to be efficiently handled in a CCP environment, these products should not be deemed eligible for central clearing.

Guidance 4.1:

The margin methodology should be worked out by the CCP together with its risk committee, monitored by the competent authority. The additional benefit of a review by an independent group and how this independence could be defined also needs to be elaborated.

Guidance 6.1:

An allocation of the portfolio of a defaulting member to surviving participants in case of a failed auction process impedes the ability of surviving participants to manage their risks effectively. Such a possibility might incentivise CCPs to establish a biased waterfall process in order to protect their commercial interest to the detriment of its users.

Guidance 6.3:

A situation where a CCP has an incentive to declare the default of a participant prematurely also needs to be prevented by an adequate governance agreement.

Guidance 6.4:

The ability of a CCP to effect the transfer of client positions in the event of a default of the relevant member will be an essential instrument to mitigate risks for clients. Legal certainty over the effectiveness of such transfer is of paramount importance. It must be ensured that such transfer is valid and enforceable and cannot be voided under applicable insolvency laws, especially since these laws have not yet been fully harmonised in this respect within the EU. To ensure the requisite legal certainty, it will be necessary to achieve such full harmonisation. The relevant legal certainty should also be a precondition for the regulatory permission of a CCP.

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Recommendation 8:

Links with other types of market infrastructures should be limited. Interoperability links with other CCPs could be a source of additional risks. Ample experience with interoperability for cash securities has to be gained before analysing a possible extension to derivatives.

Recommendation 13:

In order to represent the interested parties adequately we believe that CCPs should have a Risk Committee comprising the participants of the CCPs, including the buy-side/indirect participants/non-clearing members, in a proportion that is commensurate to the risk derived from the possible failure of the CCP. The buy-side should participate with appropriate and fair shares, to be able to present their interests. We could imagine ESMA as a neutral third party to take part in the decision finding of the risk committee as a counterbalance to the superior participation of clearing-members. Furthermore, the decisions of the risk committee within the remit of its competence should be binding for the CCP because the clearing members bear the ultimate risk through their contributions.

Guidance 14.1:

Providing the relevant supervisors with the necessary information to ensure the stability of OTC derivatives markets should be supported. CCPs delivering detailed information to the markets would be problematic. Derivatives are open positions. If positions were to be published, this could be exploited by others, harming market liquidity in the long run. Publishing aggregate information only is a minimum condition in this respect.

Should you have any questions, please do not hesitate to contact us.

Kind regards,

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The European Association of Public Banks (EAPB) represents the interests of 35 public banks, funding agencies and associations of public banks throughout Europe, which together represent some 100 public financial institutions. The latter have a combined balance sheet total of about EUR 3,500 billion and represent about 190,000 employees, i.e. covering a European market share of approximately 15%.

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