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**Comment of the
Zentraler Kreditausschusses
on
CPSS-IOSCO's Consultative report
“Guidance on the application of the 2004 CPSS-IOSCO Recommendations for
Central Counterparties
to OTC derivatives CCPs”**

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The Zentraler Kreditausschuss would like to thank the Committee on Payment and Settlement Systems as well as the Technical Committee of the International Organization of Securities Commissions for the opportunity to comment on the consultative report on „Guidance on the application of the 2004 CPSS-IOSCO Recommendations for Central Counterparties to OTC derivatives CCPs“. We believe that a structured and regular dialogue between the market infrastructures, users, and public policy officials is proving its worth in this field. This dialogue should continue to fashion consensual regulatory solutions that reward open approaches and that support the smooth implementation of those solutions.

Generally, we agree with CPSS-IOSCO that extension of the use of CCPs for eligible derivatives will enhance systemic stability. In a number of letters, the most recent one dating from March 2010 the G14 a group of large global derivatives dealers committed themselves to ambitious targets for central clearing in this respect.

Building efficient, safe and sound market infrastructures is of utmost importance, even more so when further extending central clearing to the derivatives space. We feel that the consultative report of CPSS-IOSCO is generally asking the right questions for CCPs to answer in order to demonstrate to its authorities, its users as well as to the wider public that stability is the key priority.

Specific remarks on the recommendations

Guidance 1.1

Regarding documentation that governs the rights and obligations we would like to affirm that CPSS-IOSCO correctly assessed, that derivative transactions are entered on the basis of more than one type of standardised master agreements ("...(ISDA) and other industry groups"). In particular transactions of non-financial entities or between counterparties in one jurisdiction are often not entered on the basis of an international master agreement documentation (such as the ISDA Master Agreements) but on the basis of a standardised national master agreement (such as the German Master Agreement for Financial Derivative Transactions or the FBF-AFB Master Agreement). OTC Derivative transactions with the European Central Bank are made on the basis of the EFB Master Agreement (or European Master Agreement – EMA)¹.

¹ See Guideline of the European Central Bank of 20 June 2008 on the management of the foreign reserve assets of the European Central Bank by the national central banks and the legal documentation for operations involving such assets (recast) (ECB/2008/5) The relevant documentation is fully standardised and safeguards a comprehensive legal framework, including collateralisation e.g. the „Besicherungsanhang“ (Collateral Annex) to the German Master Agreement . Any future regulation must therefore ensure that certain types of standardised master agreements are not inadvertently prejudiced.

Guidance 2.2 (and guidance 6.1)

The recommendation to arrange *ex ante* the secondment of traders from non-defaulting participants to assist the CCP in hedging and close-out procedures in situations of market stress deserves careful analysis. Usually markets will be or will become stressed when a Clearing Member defaults. In times of stressed markets banks are in definitive need of exactly the expertise they are expected to second. We consider CCPs to be professionally-driven organisations, hence responsible for the quality of the service they provide to their clients and for the arrangement of the necessary resources to deliver that service. Banks will second experts as much as they can, because a smooth operation of the CCP is in their interest, but a binding ex-ante agreement may prove counterproductive.

Recommendation 3 / Guidance 3.1:

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

Recommendation 4

As a general remark, we believe that CCPs should only have a limited and ex ante clearly defined right to reuse collateral. This reuse of collateral should not bring any additional risks to the CCP or its users.

Guidance 4.1

The margin methodology should be elaborated by the CCP in close cooperation with its risk committee and thoroughly monitored by the competent authority. We would like to learn more about the additional benefit of a review by an independent group and how this independence could be defined.

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. Furthermore, 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 6.2

Again, if risks 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 6.3

What also needs to be prevented by an adequate governance agreement is a situation where a CCP has an incentive to declare the default of a participant prematurely (e.g. to minimise the probability of own capital being depleted later on).

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 therefore of paramount importance. Specifically, it must be ensured that such transfer is valid and enforceable and cannot be voided under applicable insolvency laws. Insolvency laws within the European Union have not yet been fully harmonized in this respect. Consequently, to ensure the requisite legal certainty, it will be necessary to achieve such full harmonization. In addition, because of the importance of this aspect, the relevant legal certainty should also be a precondition for the regulatory permission of a CCP.

Recommendation 8:

We strongly agree with the limitation of CPSS-IOSCO to links with other types of market infrastructures. Interoperability links with other CCPs could be a source of additional risks, as recently recognised by regulators. This is even more so for derivatives. While an appealing concept theoretically, we believe that 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 CCPs' participants (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 and adequate measures should be ensured to safeguard the interests of the buy-side/non-clearing members. Furthermore, the decisions of the Risk Committee within the remit of its competence (e.g. the CCPs' risk management function, including possible expansion of the CCP's clearing activity) should be binding for the CCP because the clearing members bear the ultimate risk through their contributions.

Guidance 14.1

While we are supportive of providing the relevant supervisors with the necessary information to ensure the stability of OTC derivatives markets, we are a bit more hesitant on the role CCPs could play in delivering market transparency to the wider public. Detailed information to the markets could be problematic. In particular, derivatives are open positions. If positions were to be published, this could in certain cases be exploited by others, harming market liquidity in the long run. Publishing aggregate information only – as stated in the guidance – is a minimum condition in this respect.