

Derivatives and Market
Infrastructure Consultation
9th July 2010
Response from



The Depository Trust & Clearing Corporation



Euro CCP Ltd.

DTCC Derivatives Repository Ltd.

Contact person:
Andrew Douglas
Head of Public Affairs, Europe
awdouglas@dtcc.com

Introduction

The Depository Trust & Clearing Corporation (DTCC) would like to thank the European Commission for providing the opportunity for industry participants and practitioners to provide direct input to the development of legislation in a critical area of the European financial markets. Given the importance of the proposed legislation to the future safety of the European financial markets, we would appreciate that in the future the Commission reverts to providing the proposed legal text which has been the established practice for MiFID, Capital Requirements Directive and other proposed legislative instruments.

It is clear that risk mitigation and market transparency are both vital to achieving enhanced safety in global and European markets. Regulation around the establishment and operation of central counterparties (CCPs) and trade repositories will be key features of enabling the market to meet these goals.

It is also critically important that European and US legislation is harmonised in order to avoid the potential for regulatory arbitrage.

DTCC is pleased to offer input based on our 37 years of operating as a CCP, together with being the operator of the global trade repository for credit derivatives since 2006. We will also be launching an equity derivatives repository in July 2010.

For the avoidance of doubt, Section I on '*Clearing and risk mitigation of OTC derivatives*' and Section IV, '*Reporting obligation and requirements for Trade Repositories*' are taken to be specific to the OTC derivatives space.

Section II, '*Requirements for Central Counterparties*' and Section III, '*Interoperability*', are taken to be generic requirements covering CCP clearing derivatives, cash, commodity and FX instruments.

Comments have been provided in the following format:

1. All changes to the original consultation text are highlighted in yellow.
2. Suggested new text is in CAPITALS.
3. Suggested deleted text is ~~struck through~~.

Following each section of suggested text is a rationale as to why the recommended text should be taken into consideration. Following certain sections where we do not suggest alternative text are observations of substantive points we would like the Commission to consider.

From the points made in the various sections, we would like to highlight the follow key themes:

- As a general principle, ESMA should be responsible for the authorisation of CCPs, providing pan-European consistency. Daily supervision should be the responsibility of the relevant competent authority.

Section I: Clearing and risk mitigation of OTC derivatives

- A CCP cannot be forced to either:
 - Clear contracts on which it cannot offer adequate risk management.
 - Accept as direct clearing members institutions that fail the CCP membership criteria.

Section II: Requirements for Central Counterparties

- Conflicts of interest should be managed through required governance arrangements rather than mandated ownership structure. We also support efforts made to ring-fence CCP assets from client assets.
- We support improved transparency in clearing and stress that transparency should be at a sufficient level for users to select their service provider in markets where there is competitive clearing.
- In a number of places, the consultation appears to define a quasi-supervisory role for CCPs in relation to the clients of its clearing members. As CCPs have no contractual relationship with clients of clearing members, we are strongly opposed to such a role.
- The provision of 'passporting' should be incorporated to promote the development of pan-European Union (EU) clearing facilities which are needed to support a single capital market.
- The provision of regulatory 'equivalence' should be incorporated to allow access by third-country clearing providers to the EU.

Section III: Interoperability

- Competitive and safe clearing is important to enable the EU single market to be an attractive investment destination for global investors.
- An effective competitive environment with allows users meaningful choice can use either trade feed access or CCP interoperability as the starting point.

Section IV: Reporting obligation and requirements for Trade Repositories

- DTCC strongly supports Option A, reporting of all trades whether cleared or not, to a trade repository.
- For registration of trade repositories, DTCC believes that the optimal solution for providing accurate, complete and timely regulatory support is via reporting to a central

global trade repository per asset class, which may be located outside of the EU, identified as Option 2 in the consultation.

- To ensure that regulatory access to data held in a third country is guaranteed, it may be necessary for the global provider to establish a subsidiary within the EU.

Section I: Clearing and risk mitigation of OTC derivatives

Q (1a) - What are stakeholders' views on the clearing obligation, the process to determine the eligibility of OTC derivative contracts for mandatory clearing and its application?

Suggested text

1. Clearing obligation

- a) No comments
- b) No comments
- c) No comments

2. Eligibility for the clearing obligation

- a) No comments
- b) No comments
- c) No comments
- d) No comments

Observation

In principle, the two-pronged bottom up and top down approach to the establishment of the clearing obligation and eligibility of OTC derivatives contracts seems a logical solution:

- A CCP determines its appetite for clearing of certain categories of derivative contract and seeks approval from its competent authority. ESMA then determines the applicability of the clearing obligation.
- ESMA & ESRB determine contracts subject to the clearing obligation but for which there could potentially be no agreed clearing facilities.

Such a solution could create certain tensions:

- If ESMA unilaterally confirms a contract is eligible for clearing but for which there is no authorised CCP, even though there is an obligation on the counterparties to employ a CCP, there can be no compulsion of a CCP to offer clearing if in the opinion of the CCP the risk cannot be managed appropriately. This begs the question of whether ESMA should only be able to declare a clearing obligation for a contract if at least one CCP has confirmed its willingness to provide clearing facilities.
- ESMA and the local competent authority may disagree on a contract's eligibility.

In addition to these tensions, there are several practical issues which would need further explanation if such a solution is to be effective:

- What is the process to be followed if ESMA and the local competent authority disagree on the clearing obligation? i.e. ESMA declares a contract eligible for clearing but the local regulator does not, or vice versa.

- If no clearing facilities are 'volunteered', what would ESMA's next steps be?

Taking into account the above, we would recommend that the bottom up approach be regarded as the conventional route by which the clearing obligation is identified with the top down approach being utilised only in exceptional circumstances and being subject to at least one CCP being willing to offer clearing facilities.

Q (1b) - Do stakeholders agree that access from trading venues to CCPs clearing eligible contracts should be guaranteed?

Suggested Text

3. Access to a CCP

In order to give full effect to the clearing obligations, 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 derivative contracts will have the obligation to accept clearing of such contracts on a non-discriminatory basis, regardless of the venue of execution.

A CCP CANNOT BE FORCED TO ACCEPT AS CLEARING MEMBERS THOSE COUNTERPARTIES WHO FAIL TO MEET THE MEMBERSHIP CRITERIA OF THE CCP. SUCH COUNTERPARTIES WOULD ACCESS CLEARING SERVICES THROUGH AN INTERMEDIARY THAT IS A CLEARING MEMBER.

Rationale

CCPs have strict membership criteria based on detailed prudential standards that a potential member needs to meet. It would therefore be unacceptable to override these criteria simply because a CCP has agreed to clear a particular category of derivatives contract.

Q (2) - Do stakeholders share the general approach set out on the application of the clearing obligation to non-financial counterparties that meet certain thresholds?

4. Non-financial undertakings

Suggested text

- a) No comments
- b) No comments

Observation

In principle, we share the general approach proposed, subject to an understanding of the detail in relation to the clearing obligation of a financial counterparty to a trade with a non-financial counterparty. Should a corporate complete an OTC derivatives contract with a

financial organisation and the corporate is exempt, the corresponding obligation of the financial institution needs to be clearly defined.

Q (3) - Do stakeholders share the principle and requirements set out on the risk mitigation techniques for bilateral OTC derivative contracts?

5. Risk mitigation techniques for non-cleared contracts

Suggested text

- a) No comments
- b) No comments

Observation

We agree with the principle and requirements as defined in the text on the assumption that the differential capital weighting system is maintained to encourage the use of centralised clearing.

Section II: Requirements for Central Counterparties

Q (4a) - Do Stakeholders share the general approach set out on the 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?

Having successfully operated clearing facilities in the largest securities market for over three decades, including the period covered by the most recent and serious global financial crisis, we believe we have a unique perspective on the debate on requirements for central counterparties.

In general, we agree with many of the proposals outlined in this consultation but would like to take this opportunity to raise the following points:

1. Organisational requirements:

Suggested text

A CCP must 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 and those for other operations of the CCP.
- 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 the transactions it has processed.
- Persons who effectively direct the business should be of sufficiently good repute and experience so as to ensure the sound and prudent management of the CCP. **AT LEAST THREE OF ITS MEMBERS SHOULD BE** independent both from other board members and from clearing members **AND THE MANAGEMENT OF THE CCP SHOULD BE REPRESENTED BY NOT MORE THAN TWO BOARD MEMBERS.**
- The competent authority should be informed about the identity of shareholders **(INCLUDING PUBLICLY TRADED SHARES) WHEN A SHAREHOLDING REACHES A PREDETERMINED THRESHOLD, TO BE ESTABLISHED BY ESMA** 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).

Rationale

We believe as a general principle that the correct structuring of governance of a CCP is more important than the ownership structure, a point we will return to later.

In this regard, we are fully supportive of the need to establish independence of governance from ownership and believe that the guidelines identified in the consultation document are of considerable merit. Indeed, our own governance policy is closely aligned with these guidelines. However, whilst we support the principle of independent directors we believe that their true value is limited if they do not hold relevant skills and experience. Simply having a prescribed minimum number of independent directors on a Board will not in itself provide appropriate oversight and governance control.

2. Risk Committee

Suggested text

- a) A mandatory establishment of a Risk Committee, composed of REPRESENTATIVES OF its clearing members and independent BOARD MEMBERS. THE RISK COMMITTEE MAY ALSO HAVE ONE OR MORE REPRESENTATIVES OF THE CCP MANAGEMENT ON THE COMMITTEE TO PROVIDE SUBJECT MATTER EXPERTISE. The advice of the Risk Committee should be independent from any ABILITY OF direct influence by the management of the CCP TO OVERRIDE A DECISION OF THE RISK COMMITTEE.
- b) The mandate, the governance arrangements to ensure its independence, the operational procedures, the admission criteria and the election mechanism of the Risk Committee must be clearly defined. The governance arrangements will be publicly available and would at least determine that the Risk Committee is chaired by an independent BOARD DIRECTOR, reports directly to the board and holds regular meetings.
- c) No comments
- d) The members of the Risk Committee should be bound by confidentiality. If the chairman of the Risk Committee determines that a member has an actual or potential conflict of interest on a particular matter, then AT THE DISCRETION OF THE CHAIRMAN OR ALTERNATE, that member should not be entitled to receive any material relating to that matter.
- e) No comments
- f) A CCP should allow the clients of clearing members to participate in the Risk Committee or alternatively, it should establish appropriate consultation mechanisms that ensure their interests OF CLIENTS OF CLEARING MEMBERS are adequately represented.

Rationale

We support the principle of establishing an independently chaired Risk Committee and would add the following specific comments:

- The Risk Committee should not be involved in the day to day running of the CCP, its role being that of policy advisor.
- Whilst we believe that the Risk Committee should be 'independent from any ABILITY OF the management of the CCP to override a decision of the Risk Committee', we also believe it appropriate to permit a representative from the management of the CCP on the Risk Committee to provide relevant subject matter expertise.
- We believe that the Risk Committee should be composed only of representatives of the direct clearing member community of the CCP and independent Board members ('administrators'), plus possibly a representative of the CCP management as identified above. Whilst the case for direct clearing member involvement supported by independent Board members is of clear value, we regard the case for membership of the Risk Committee by clients of clearing members (Non Clearing Firms or NCFs) to be less clear given their contractual agreement is with the clearing member, not the CCP. Consequently, we believe their input is more appropriately sourced through the establishment of consultation mechanisms such as advisory groups.
- Where possible, we believe that one or more members of the Risk Committee should have relevant risk management expertise.

We also support the principle of 'comply or explain' in relation to the ultimate responsibility for managing the business, which must remain with the Board of the CCP. If the Board chooses to ignore the advice of the Risk Committee, it should be able to explain why if asked to do so by the competent authority.

3. *Conflicts of interest*

In the preamble to this section, we believe the example should be either expanded to include 'Exchange owned' as well as 'User owned', or alternatively the 'User owned' example should be deleted.

- a) No comments
- b) No comments
- c) No comments
- d) No comments
- e) No comments

4. *Outsourcing*

- a) No comments
- b) No comments

- c) No comments

5. Participation requirements

Suggested Text

- a) No comments
- b) No comments
- 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.~~
- d) No comments
- e) No comments
- f) A CCP may impose specific obligations on clearing members. ~~SUCH OBLIGATIONS SHOULD BE IDENTIFIED IN THE CCP RULE BOOK AND THE RULE BOOK MUST BE PUBLICLY AVAILABLE, 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.~~

Rationale

Whilst broadly in agreement with the six principles and requirements identified, we would question two specific requirements:

- *Bullet (c)*: The practicality of the need for a CCP to collect information derived from the 'know your client' process of its clearing members as expressed in the second half of para II (5) (c). There exists no contractual relationship between the CCP and clients of its clearing members and the provision of such data could be seen to compromise client confidentiality. The CCP responsibility should be limited to understanding of the nature of the relationship with its direct clearing member, not the relationship between the clearing member and its client. We would, therefore, suggest that this recommendation be removed.
- *Bullet (f)*: We believe this requirement can be simplified as shown to present a more flexible approach. Any specific references to default procedures should be dealt with in the regulation covering default.

6. Transparency

Suggested Text

- a) A CCP should publicly disclose the prices and fees associated with services provided. It should disclose separately the prices and fees of single services and functions provided, including discounts and rebates and the conditions to benefit from these

reductions. It should allow its clearing members ~~and, where relevant, their clients~~ to access specific services separately.

- b) A CCP should disclose to clearing members ~~and clients~~ the risks associated with the services.
- c) A CCP should ~~publicly~~ disclose ~~TO THE COMPETENT AUTHORITY~~, key information on its risk management model ~~METHODOLOGY~~ and assumptions to perform the stress tests.
- d) A CCP should publicly disclose the ~~SOURCE OF THE PRICE INFORMATION, AND FOR ILLIQUID INSTRUMENTS HOW THE PRICE IS DETERMINED, price information~~ used to calculate its ~~end-of-day~~ exposures with its clearing members. ~~and the volumes of the cleared transactions for each class of instruments.~~

Rationale

It is clear that transparency of certain information over and above price and fees facilitates user selection of clearing facilities based on suitability rather than simply cost. There is, however, a clear danger that 'over-transparency' could undermine a CCP's role as an institution whose primary function is the mitigation of risk. Consequently, we would encourage ESMA to publish guidelines outlining exactly what service risk information could be disclosed in order to ensure commonality and harmonisation of disclosure amongst the CCP community. In doing so, we would refer to the principle established under MiFID, of differentiating the level of 'protection' (in this case through the disclosure of information) applicable between 'retail' and 'professional' counterparties, i.e. there should be an assumed level of competency and risk awareness associated with the use of CCPs as financial 'professionals' that should guide the need for service risk disclosure.

Additionally, we would only see this duty of disclosure being to the direct clearing member of the CCP to assist in due diligence during their service selection process. There should be no duty of direct disclosure by a CCP to clients of the clearing members, any such disclosure being an issue between the clearing member and its client.

We believe that public disclosure of key information on risk management models and stress test assumptions could infringe upon the intellectual property of the CCPs. However, the methodology of these processes should be disclosed to the competent authority.

Q (4b) – Do stakeholders consider that possible conflicts of interest would justify specific rules on the ownership of CCPs? If so, which kinds of rules?

As noted above, we are of the firm belief that establishing appropriate governance of a CCP is more important than defining an acceptable ownership structure and this is most evident in the need to avoid conflicts of interest. As a mutually owned, not-for-profit utility providing clearing services to the largest domestic securities market in the world, DTCC is owned by more than 360 different firms and we believe that this mutualised ownership

structure sits well with the fundamental concept that a CCP should mutualise risk amongst its user community. To remove this direct linkage, i.e. to eliminate or restrict the user's 'skin in the game', would in our opinion compromise the ability of a CCP to use mutualised risk as a means to align user interest with the public interest for greater safety.

We would, therefore, recommend that the Commission does not establish rules on ownership but instead focuses on the issue of appropriate governance as the correct tool for dealing with conflicts of interest.

7. Segregation and portability

Q (5) – Do stakeholders share the approach set out on segregation and portability?

Suggested Text

- a) No comments
- b) A CCP should ~~require~~ **HAVE THE CAPABILITY TO PROVIDE** each clearing member **WITH THE ABILITY** 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) No comments
- d) No comments
- e) No comments

Rationale

Whilst we are in agreement with the need to provide clients of a clearing member with the flexibility to move to another member willing to take on their obligations, we must remain cognisant of the fact that the primary goal of a CCP is to promptly close out the positions of defaulting members in a manner it deems most appropriate to the protection of both the CCP and its non-defaulting members. Accordingly, any additional obligations relating to segregation and portability should not prohibit or fetter a CCP from discharging its primary goal relating to protecting its members in a situation which requires the close out of a particular client portfolio.

Segregation: We have assumed that the term "segregate" is used to describe the ability to identify and record assets and positions separately from one account holder to another in the internal accounts of a CCP rather than meaning the use of separate external custodial/bank accounts. Generally we would advocate that segregation is the responsibility of the clearing member, CCPs being able to facilitate choice but unable to enforce such an obligation on the clearing member. Clearing members should already be under an obligation to explain to their clients the risks associated with different levels of account segregation in

the case of clearing member default under relevant national client money rules. We do not believe that CCPs should be subject to this type of obligation as CCPs do not have any contractual relationship with the underlying clients and may not necessarily have full visibility of the underlying client positions. In addition, CCPs should not be responsible for the accuracy of allocation of assets by a clearing member between its own account and client account(s). "Client" should not be restrictively defined (e.g. by reference to EU legislation), because non-EU clearing members may have differing obligations to segregate under their national law.

Portability: Even where a regulation overrides conflicting national laws, it is not always practical to implement as a CCP does not necessarily have, or need to have, full visibility of the underlying client positions unless the intention is that a CCP would be obligated to maintain individual accounts for positions and assets for each client (where requested). Further clarity regarding the nature of this obligation is required to determine if the proposed CCP obligation to provide segregated accounts refers to an individual account per client. If that were the case, we believe that the efficiency benefits of margin and settlement netting offered by CCPs would be materially impaired.

We would also request clarification on how margin should be transferred in those circumstances where the ownership of the margin may not be clear, i.e. part of a defaulting member's estate, if the transfer has been triggered on default.

We would recommend that this area requires further research before any final conclusions are drawn and would be happy to assist the Commission in completing such research.

Q (6) – Do stakeholders share the general approach set out 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 different lines of defence 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 sufficient to ensure access to central bank liquidity without compromising central banks' independence?

8. Prudential Requirements

Suggested Text

A. Initial Capital

- a) A CCP should have a permanent, available and separate initial capital of **at least Eur 5** million.
- b) No comments

B. Exposure management

- a) A CCP should measure and assess its exposure to each clearing member and, where relevant, to another CCP with whom it has concluded an interoperable arrangement, on a near to real time basis **SUBJECT TO THE AVAILABILITY OF RELEVANT PRICING INFORMATION.** A CCP should have access in a timely manner and on a non-discriminatory basis to the relevant pricing sources to effectively measure its exposures.

C. Margin Requirements

- a) No comments
- b) No comments
- c) A CCP should **HAVE THE ABILITY** to call and collect margins on an intraday basis, **at a minimum when pre-defined thresholds are breached.**
- d) A CCP should segregate **WITHIN ITS INTERNAL ACCOUNTS**, the margins posted by each clearing member and, where relevant, by CCPs that have interoperable arrangements
- e) A CCP should **TAKE REASONABLE STEPS TO** 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 might experience.
- f) **FOR THE AVOIDANCE OF DOUBT, THIS REGULATION SHALL NOT PREVENT CCPS FROM USING MARGIN FOR LIQUIDITY PURPOSES THROUGH SETTLEMENT BANKS AND CSDS.**

D. Default Fund

- a) No comments
- b) No comments
- c) No comments

E. Other Risk Controls

- a) No comments
- b) No comments
- 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 **25%** of the credit lines needed by the CCP.
- d) No comments

F. Default waterfall

- a) No comments
- b) No comments
- c) No comments
- d) No comments

G. Collateral Requirements

- a) No comments
- b) A CCP **may** accept as collateral to cover its margin requirements, the underlying of the derivative contract or the financial instrument that originates the CCP exposure.

H. Investment policy

- a) No comments
- b) No comments
- c) No comments
- d) No comments
- e) No comments

I. Default procedures

- a) No comments
- b) No comments
- c) No comments
- d) No comments

J. Review of models, stress testing and back testing

- a) No comments
- b) No comments

K. Settlement risk

- a) ~~A CCP MUST, when available, use central bank money to settle its transactions. If central bank money is not accessible, steps should be taken to strictly limit credit and liquidity risks.~~
- b) No comments
- c) No comments

Rationale

We are supportive of the general approach set out, with the following observations:

Initial capital: We strongly support the principle that a CCP holds a minimum initial capital and the commonly upheld figure proposed by the BIS of Euro 5m would seem to be

acceptable. We recommend that in the interests of maintaining a level playing field, this amount is not subject to revision by competent authorities and it must be made clear that the purpose of this initial capital is solely for the purposes of executing an orderly wind down; it must not be confused with capital held as part of the default risk management waterfall.

We do not believe it is necessary to hold additional capital solely for use in the event of a member default if the other risk management defences are appropriately calibrated.

Margin requirements: We believe that it is potentially destabilising to a market and its participants to set fixed intraday thresholds above which margin calls must be made. Our experience is that an assessment of the need to make such margin calls is part of the ongoing risk management for which a CCP should be responsible and that human judgement is required to avoid potential disruptions caused by a rigid margin collection mechanism.

We would also point out that this proposal calls for protection of margin money against default of a deposit taking institution and the CCP itself. With cash this is very difficult to achieve as title to cash passes and the depositor is in essence left with an IOU against the bank concerned. This seems to require a revision to banking law principles or for the creation of a complex trust system when in our view, the regulation should better focus on preserving the safety of the CCP. Cash concentration with deposit taking institutions can be managed in other ways.

We have also inserted a new bullet (f) for the avoidance of doubt, to reflect existing industry practice.

Default fund: We are in agreement that there should be a mandatory default fund in addition to margining and initial capital requirements. In general, we believe that such provisions should be consistent with those laid down by IOSCO.

Other risk controls: Whilst broadly in agreement with the Commission view, we believe implementation of the proposed 'Back stop' credit facilities (para II 8 (E) (c)) could be problematic. We believe it is fundamentally more important to ensure such a 'back stop' facility is provided, rather than setting arbitrary rules on how the facility is made up. By enforcing a 10% limit, this implies a need for at least 10 institutions to provide the necessary credit facilities. This will create unnecessary complications and expense in arranging such facilities and in some circumstances, force a CCP to seek credit facilities from Tier 2 or 3 institutions which may be detrimental to the quality of the facility provided. We have therefore recommended a 25% limit which we believe to be more practical.

Collateral requirements: In bullet (b), it should be clear that this is not a compulsion, rather an option. Therefore the word 'may' should remain as 'may' in the final text.

Settlement Risk: We do not advocate introducing the type of obligation defined in bullet (a) into the regulation as the use of a central bank settlement money model may not always be practicable as it requires a CCP to have access to an account with the central bank of issue. In a multi-currency system a CCP is unlikely to have remote access to accounts at all of the central banks of issue. In addition, national central securities depositories in the EU already settle in central bank money and accordingly we believe this clause is redundant.

Q (7a) – Do stakeholders share the general approach set out on the recognition of third country CCPs? Are the suggested criteria sufficient? Do stakeholders consider that additional criteria should be considered?

There are clear precedents for the recognition of third country service providers through mutual recognition and equivalence agreements between regulators. We would therefore agree with the text as laid out which appears to reflect this condition.

Q (7b) – Do stakeholders agree with the extension of the clearing obligation to contracts cleared by third country CCPs to ensure global consistency?

Whilst it is clear why such an extension of the clearing obligation to contracts cleared by third country CCPs might be desirable, we do not believe that it is practicably enforceable as it would require some form of extraterritorial jurisdiction over CCPs in third countries.

Section III: **ACCESS AND Interoperability**

Q (8) – Stakeholders’ views are welcomed on the general approach set out on interoperability and the principles and requirements on managing risks and approval.

Suggested text

1. ACCESS

- a) **A CCP HAS THE RIGHT TO NON-DISCRIMINATORY ACCESS TO THE DATA OF ANY PARTICULAR TRADING VENUE AND ACCESS TO ANY RELEVANT SETTLEMENT SYSTEM THAT IT NEEDS FOR THE PERFORMANCE OF ITS FUNCTIONS.**
- b) **WHERE A CCP ACCESSES THE DATA OF ANY PARTICULAR TRADING VENUE UNDER PARAGRAPH (a) ABOVE THE CCP ACCESSING THE DATA WILL HAVE THE RIGHT TO ENTER INTO INTEROPERABLE ARRANGEMENTS WITH OTHER CCPS CONNECTED TO THAT TRADING VENUE IF THE REQUIREMENTS BELOW ARE FULFILLED.**

2. Interoperability

- a) A CCP has the right to enter into an interoperable arrangement with another CCP if the requirements below are fulfilled.
- b) When establishing an interoperability arrangement with another CCP for the purpose of providing services to particular trading venue, a CCP would need to have non-discriminatory access to the data of the particular trading venue that it needs for the performance of its functions and to the relevant settlement system

3. GENERAL CONDITIONS

- a) Any direct or indirect restriction to the right of interoperability, ~~data feed access, and/or settlement system~~ referred to in paragraphs 1(a), 1(b), 2(a) or 2(b) would be solely aimed at controlling the risk that arises from an ~~access or~~ interoperability arrangement. Any denial of interoperability, ~~data feed and/or settlement system access~~ would be justified in writing by the party receiving the request and would state the risk considerations on which the denial is based.
- b) **ANY RESTRICTION OR DENIAL OF THE RIGHT TO INTEROPERATE RAISED UNDER PARAGRAPH (3A) ABOVE SHALL BE COMMUNICATED IN WRITING BY THE PARTY RECEIVING THE REQUEST WITHIN 30 CALENDAR DAYS OF RECEIPT OF THE REQUEST IN QUESTION.**
- c) **IN THE EVENT A RESTRICTION RELATING TO OR A DENIAL OF THE RIGHT TO INTEROPERATE IS RAISED UNDER PARAGRAPH (3B) ABOVE THE REQUESTING PARTY MAY REQUEST ESMA AND/OR THE RELEVANT COMPETENT AUTHORITY TO REVIEW THE RESTRICTION OR DENIAL IN QUESTION AND DETERMINE WHETHER THE RESTRICTION AND/OR DENIAL IS BASED ON LEGITIMATE GROUNDS AIMED AT CONTROLLING RISK ARISING FROM THE INTEROPERABILITY REQUEST.**

4. *Managing risks arising from an interoperability arrangement*

- a) No comments
- b) No comments

5. *Approval of interoperability arrangement*

- a) THE PRINCIPLE OF "PASSPORTING" CCP SERVICES ACROSS ALL EU MEMBER STATES SHALL APPLY TO THE SERVICES OF A CCP. I.E. A CCP AUTHORISED BY ESMA AND/OR THE RELEVANT COMPETENT AUTHORITY FOR PERFORMANCE OF ITS FUNCTIONS IN THE EUROPEAN UNION SHALL BE DEEMED TO BE AUTHORISATION TO OPERATE IN ANY AND ALL MEMBER STATES WITHOUT FURTHER APPROVAL BY ADDITIONAL NATIONAL REGULATORY AUTHORITIES.

Rationale

At present, the prevailing cost of clearing in Europe is approximately 15-20 times that of the US. The failure of the existing European market structure to create meaningful choice for users (i.e. trading counterparties, investors etc) in the selection and use of clearing facilities is a significant weakness. In the majority of European markets, the clearing cost is paid by the user but the choice of which CCP[s] is/are available is made by the trading platform, a structure prone to misaligned incentives and which is a logical inconsistency with the need to guarantee genuine 'best execution' under the terms of MiFID.

The provision of full user choice will bring three natural benefits to the European market:

- Individual trading venues can be supported by multiple CCPs, creating incentives for CCPs to improve price, service level and innovation as they compete to win market share.
- Individual CCPs will be able to offer clearing services to multiple trading venues, allowing the development of economies of scale.
- Users will be able to trade on multiple venues and use a CCP of their choice, reducing complexity and operational risks.

Through meaningful competition in clearing and full user choice, it can be anticipated that the natural cycle of market development will be followed, i.e. a short term fragmentation in individual markets as CCPs enter into competition followed by medium term consolidation into a fewer number of large scale providers. As clearing is a scale business, this is the necessary transitory phase for the European securities market to achieve global competitiveness.

The draft consultation text does not, in our opinion, fully establish the conditions that will allow the development of a broad user choice model as it appears to make a CCP's access to trading venue data feed conditional on the development of CCP interoperability.

Establishment of interoperability therefore remains an initial hurdle and vested interests of incumbent CCPs may, in some cases, prevent competition altogether. We believe that the

broadest levels of user choice, and therefore the market conditions most likely to result in the development a cost effective pan European clearing infrastructure, are best created through implementation of the broadest access and interoperability conditions. Thus, not only should these conditions promote interoperability leading to trade data access, but trade data access should lead to interoperability. In addition to the rights outlined in the original consultation text, CCPs must, therefore, have the right of unconditional non-discriminatory access to trade feeds from a particular venue leading to interoperability with other CCPs clearing for the same venue. Ultimately, these two conditions allow the same goal to be reached using either access or interoperability as a starting point.

- Starting with access allow CCPs to build scale across trading venues.
- Starting with interoperability allows competition within individual markets.

For this process to work effectively and for the European market to derive maximum and timely benefit, it would be essential for the Commission, ESMA or the relevant competent authority as appropriate to specify the following aspects:

- The specific “risk” grounds acceptable for refusal of requests for interoperability.
- The process for appeal.
- The time limit for responding to requests for access or interoperability – we have suggested a time limit of 30 calendar days within our suggested text.

It should also be noted that within Section 3, we have recommended deletion of ‘data feed access’ together with ‘and/or settlement system’ as these rights of access do not, in our opinion, raise the same risk issues as interoperability.

We have also made explicit reference to the principle of passporting of CCP services between EU states which we believe should be applicable in this case.

Section IV: Reporting obligation and requirements for Trade Repositories

The functions performed by a trade repository include:

- Position collection.
- Data validation and cleansing.

These activities will create public transparency of aggregate data and regulatory transparency on position data and deal books by participating firm.

We believe it is important that the legislative proposals carefully define the role of a trade repository in the OTC markets. There are many other functions relevant to OTC markets, inter alia:

- Trade execution and compression services.
- Portfolio reconciliation and valuation.
- Legal record keeping.
- Enabling counterparties to assign (change ownership of) contracts electronically.
- Managing life cycle events e.g. bankruptcies, reorganisations, renaming, etc.
- Calculating and netting cash flows, etc.

Whilst important within the context of the operational processing for some or all of the OTC asset classes, these fall outside the scope of the collection and assembling of complete information on outstanding contracts as defined in this consultation.

Furthermore, DTCC believes that fragmentation of data through multiple implementation of multiple repositories is a key risk to realising the regulatory objectives of increasing the transparency achieved by maintaining data in a centralised location. The OTC Derivatives Regulators' Forum has been very successful in establishing guidance for the Trade Information Warehouse (TIW) and enabling it to provide a complete perspective on the credit derivatives market to many international regulators. Fragmented repositories (including any CCPs that may not elect to report to a repository) make the ability to produce consolidated information far more complicated and significantly less timely:

- Regulators will need to obtain data from multiple sources, and consolidate themselves.
- True market level concentrations may be diluted and less easy to detect.
- The public may not have direct access to all the data necessary to provide a consolidated view.
- It may not be possible to create a full understanding of the net open position from multiple sources. The absolute values presented by net positions outputs are not additive.
- Obtaining data from multiple sources and consolidating the results will inevitably take longer than obtaining a consolidated report from a central source.

- Given the nature of OTC derivative products, in a multi-repository environment it is not always obvious which repository (or repositories) a given position should be registered in. Global rules will be needed to ensure that positions are neither omitted nor duplicated, and these rules implemented in firms at material aggregate cost.

Q (9) – What are stakeholders’ preferred options on the reporting obligation and on how to ensure regulators’ access to information with Trade Repositories?

Reporting obligation: DTCC is supportive of Option A.

Suggested text

- a) ALL Financial counterparties, INCLUDING NON FINANCIAL COUNTERPARTIES, would report the details of any derivative contract they have entered into, WHETHER CENTRALLY CLEARED OR NOT, and any modification, including termination thereof, to a registered trade repository. The details would be reported no later than the working day following the execution, clearing, modification or termination of the contract.
- ~~b) A financial counterparty would report the details of a derivative contract with a non-financial counterparty or any other entity also on behalf of the latter, unless these entities report these details themselves~~
- b) PRIVATE INDIVIDUALS ARE EXEMPTED FROM THIS REPORTING REQUIREMENT PROVIDED THAT THE FINANCIAL COUNTERPARTY WITH WHOM THEY HAVE TRADED REPORTS THE TRADE.
- c) COUNTERPARTIES SHOULD BE ALLOWED TO MAKE USE OF AGENTS TO ACTION THEIR SUBMISSION WHERE NECESSARY. SUCH AN ARRANGEMENT SHOULD BE FORMALLY DOCUMENTED BETWEEN THE COUNTERPARTY, AGENT AND THE REPOSITORY.
- d) ESMA SHOULD DEVELOP TECHNICAL STANDARDS TO ENSURE THAT ACCESS TO REPOSITORIES IS AVAILABLE TO ALL POTENTIAL COUNTERPARTIES.
- e) IF A REGISTERED TRADE REPOSITORY IS NOT CAPABLE OF RECORDING THE DETAILS OF A SPECIFIC DERIVATIVE CONTRACT, OR IF NO REGISTERED TRADE REPOSITORY EXISTS FOR THAT TYPE OF CONTRACT, FINANCIAL COUNTERPARTIES MUST REPORT THE DETAILS OF THEIR POSITIONS IN THOSE CONTRACTS TO THE COMPETENT AUTHORITY.
- f) ESMA MUST DEVELOP DRAFT TECHNICAL STANDARDS TO DETERMINE THE DETAILS, TYPE, FORMAT AND FREQUENCY OF THE REPORTS REFERRED TO FOR THE DIFFERENT CLASSES OF DERIVATIVES. THESE MUST AT MINIMUM ENSURE THAT:
 - THE PARTIES TO THE CONTRACT AND, IF DIFFERENT, THE BENEFICIARY OF THE RIGHTS AND OBLIGATIONS ARISING FROM IT ARE APPROPRIATELY IDENTIFIED.
 - THE CHARACTERISTICS OF THE CONTRACT, INCLUDING THE UNDERLYING, THE MATURITY AND THE VALUE ARE REPORTED.

Rationale

DTCC believes that there is benefit in positions being reported to the repository by both counterparties. This should include any derivative contract entered into by the party, both EU and non-EU. Our experience shows that where both parties report the transaction, there will be a general improvement in the quality of the underlying data.

As we believe that reporting by both parties to a trade is desirable, we recommend that the regulation should promote such reporting to ensure best quality data and enable public and regulator reliance on this data, in the following ways:

- It should permit the use of reporting agents with such arrangements being formally documented, including recognition by the repository. Formalisation allows:
 - Precise and consistent identification of customers.
 - The repository to obtain necessary consents to share data, which will still be important for transactions outside the EU in which EU regulators have an interest.
- It should support the needs of all market participants including smaller participants by ensuring availability of cost effective communication methods, e.g. customer affirmation via a web portal interface, with customers' trades based on trade submissions from the price-making firms.
- Recognise and encourage the use of electronic solutions for other services relevant to OTC derivatives but which are beyond the scope of repositories, e.g. execution, confirmation, automated give-up and portfolio matching. With the support of the OTC Derivatives Supervisors' Group, industry participants have been significantly increasing their use of electronic connectivity, and we believe that electronic connectivity for most participants will be part of the transaction lifecycle. Such connectivity will support the reuse of these electronic solutions to enable submissions of trades to repositories.

To the extent that any proportionality is considered, we suggest this exclusion should be applicable to private individuals only, with financial firms submitting trades against private individuals without counterparty name disclosure to ensure data protection is afforded to private individuals.

Requirement for registration of a trade repository: DTCC is supportive of Option 2, recognition of third country trade repositories.

Suggested text

- a) MARKET PARTICIPANTS SHOULD REGISTER TRADES WITH A REPOSITORY. WHERE A REPOSITORY IS LOCATED IN A THIRD COUNTRY, EUROPEAN AUTHORITIES WILL REQUIRE GUARANTEED ACCESS TO SUCH TRADE REPOSITORIES.
- b) A REPOSITORY ESTABLISHED IN A THIRD COUNTRY MUST BE ALLOWED TO PROVIDE REPOSITORY SERVICES TO EUROPEAN REGULATORS, SUPERVISORS AND MARKET

PARTICIPANTS ESTABLISHED IN THE EUROPEAN UNION, SUBJECT TO CERTAIN CRITERIA SUCH AS:

- THE REPOSITORY BEING REGISTERED AS SUCH WITH ESMA.
- THE REPOSITORY BEING AUTHORISED AND SUBJECT TO EFFECTIVE AND STRINGENT SUPERVISION AND REGULATION IN THAT THIRD COUNTRY.
- THE COMMISSION HAVING ADOPTED A DECISION RECOGNISING THE LEGAL AND SUPERVISORY FRAMEWORK OF THAT THIRD COUNTRY AS EQUIVALENT TO THE REGULATORY FRAMEWORK OF THE EUROPEAN UNION.
- THE EXISTENCE OF APPROPRIATE CO-OPERATION ARRANGEMENTS BETWEEN THE RELEVANT COMPETENT AUTHORITIES.
- THE GUARANTEE OF UNFETTERED ACCESS TO INFORMATION REQUIRED BY REGULATORS AND SUPERVISORS ACROSS THE EU IN SUPPORT OF THEIR STATED SUPERVISORY DUTIES.

- c) IN CASES WHERE ACCESS BY EUROPEAN AUTHORITIES IS RESTRICTED FOR WHICHEVER REASON, THE CONDITIONS FOR RECOGNITION AND REGISTRATION BY ESMA WOULD NO LONGER BE MET. IN SUCH CASES, REGISTRATION OF TRADE REPOSITORIES REQUIRES ESTABLISHMENT IN THE EUROPEAN UNION. TO MEET THIS REQUIREMENT, THIRD COUNTRY TRADE REPOSITORIES NEED TO ESTABLISH A SUBSIDIARY IN THE TERRITORY OF THE EUROPEAN UNION TO BE REGISTERED FOR THE PURPOSE OF SATISFYING THE REPORTING OBLIGATION. FURTHERMORE, TO MEET THIS REQUIREMENT, IT IS NECESSARY TO ENSURE THAT REGISTERED TRADE REPOSITORIES IN THE EU RECEIVE ALL THE INFORMATION THAT EUROPEAN AUTHORITIES NEED TO EXERCISE THEIR TASKS, NOT LIMITED TO ALL TRADES REFERENCING EU BASED UNDERLYERS, AS WELL AS ALL TRADES WHERE AT LEAST ONE PARTY TO THE TRADE IS DOMICILED IN THE EU.
- d) IF NO TRADE REPOSITORY EXISTS FOR A PARTICULAR ASSET CLASS, POSITIONS MUST BE REPORTED DIRECTLY TO THE COMPETENT AUTHORITY DESIGNATED ACCORDING TO ARTICLE 48 OF MIFID (SEE PARAGRAPH C OF THE REPORTING OBLIGATION).

Rationale

Given the global nature of OTC markets as well as the fact that there will be a mix of centrally cleared and non-cleared positions within the portfolios of market participants, DTCC believes that all trades – whether centrally cleared or not – should be reported to a repository. At times of market stress, having all positions reported to a single trade repository will greatly reduce exposure to systemic risk by ensuring regulators can see a firm’s underlying position data and exposure from a central vantage point. To support an efficient solution that provides the necessary global transparency to regulators and other supervisors, Option 2 is the preferred solution provided that all appropriate authorities can be guaranteed unfettered access to the data held therein in support of meeting the supervisory and regulatory mandate of the requesting authority. Where a provider operates

out of the third country but that country's law prohibits unfettered access, an alternative location should be provided.

Regulation which fails to support the maintenance of a single global repository per asset class would be a retrograde step in regulatory effectiveness during times of crisis:

- Each contract is a separate instrument representing on-going obligations between contracting parties. Transfer of ownership of a contract rarely results in transfer of ownership of an underlying security, and obligations are often settled in cash, supported by their correspondent banks. As such, each contract does not necessarily have a clearly defined domicile and therefore it is not always clear to which (or how many) regional repositories such a contract should be reported, clearly risking duplication or omission of contracts.
- Where a trade on an EU reference entity is executed between two non-EU counterparties there must be an international agreement to ensure such transactions are reported to an EU repository even though neither of the counterparties is subject to EU regulation or jurisdiction. Without such an agreement, an EU based repository would only be able to produce a subset of the total exposure relating to the EU reference entity in question.
- As a corollary of the above, a trade executed between two EU counterparties (or one EU and one non-EU) that does not include an EU reference entity could be reported to an EU as well as a non-EU repository, with such duplication being difficult to identify and leading to potentially erroneous and misleading results upon aggregation.
- Not all relevant contracts will have a clearly defined EU reference entity; indeed the term "reference entity" is not applicable to all asset classes, e.g. a cross-currency interest rates trade may reference EU and non-EU reference rates.
- Where a contract is recorded with a non-EU entity that is subsequently acquired by an EU entity, there must be a clear definition of whether and when to introduce positions. Similarly for an EU entity that is acquired by a non-EU entity, is there an ongoing requirement to continue to report those trades and for how long?

DTCC envisages a global solution which recognises the international nature of trading in OTC derivatives as well as local regulator concerns about guaranteed access. We believe that such concerns can be alleviated through the establishment of a subsidiary that is capable of providing access by local regulators to a data set that is:

- Complete in breadth: i.e. contains details of all contracts relevant to EU regulatory and supervisory requirements.
- Complete in depth: i.e. contains all data elements stored for a relevant contract.
- Updated daily according to a schedule pre-agreed with the regulator.

Notwithstanding the fact that there are already existing repository services provided by private companies, with regard to European “public” utility ownership DTCC believes that, for a given asset class, a repository forms part (and only part) of an overall market infrastructure for that asset class. For it to function correctly and efficiently, it needs to leverage other parts of that infrastructure as well as work symbiotically with the market participants. For example, practical matters such as user registration, identification, permissioning, security, trade IDs as well as client support, relationship management, relationships with regulators and other market-wide activities are most effectively provided by the industry on behalf of the industry. By leveraging such processes, the incremental costs of trade repositories are kept to a minimum as well as the administration required by the market participants.

However, the point that information contained within a trade repository forms the basis for information provided to the public is well made. DTCC believes that utility provision of such services is a desirable requirement, but these goals can be achieved via an at-cost utility basis, mutual ownership and/or governance model.

Q (10) Do stakeholders share the general approach set out 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?

As a general principle, DTCC agrees that trade repositories must be subject to robust governance arrangements and supports the work of CPSS-IOSCO in this area.

Suggested text

1. Operational reliability

- a) No comments
- b) No comments

2. Safeguarding and recording

- a) No comments
- b) No comments
- c) No comments

3. Transparency and data availability

- a) No comments
- b) No comments

4. OPEN ACCESS

- a) REPOSITORIES CAN ONLY DENY ACCESS TO OTHER SERVICE PROVIDERS TO OTC MARKET PARTICIPANTS WHEN THE REPOSITORY PROVIDER ASSESSES A MATERIAL RISK TO THE QUALITY OF THE REPOSITORY SERVICE WOULD BE CREATED BY ALLOWING ACCESS TO A PARTICULAR SERVICE PROVIDER, E.G. ABILITY TO PROVIDE REASONABLE REASSURANCES AS TO THE QUALITY AND COMPLETENESS OF THE DATA PROVIDED AND THE OPERATIONAL RELIABILITY OF THEIR SERVICE. OTHER THAN DENIAL OF ACCESS ON RISK-RELATED GROUNDS, ACCESS MUST BE GRANTED WHERE:
- THE SERVICE PROVIDER REQUESTING ACCESS IS PROVIDING A SERVICE RELEVANT TO THE REPOSITORY OR ON BEHALF OF ONE OR MORE OF THE MARKET PARTICIPANTS THAT USE THAT REPOSITORY.
 - SUCH A SERVICE PROVIDER HAS THE CONSENT OF THOSE MARKET PARTICIPANTS FOR WHOM IT IS PROVIDING A SERVICE TO ACCESS THE PARTICIPANTS DATA.
 - THE SERVICE PROVIDER HAS THE ABILITY TO MEET STANDARDS REQUIRED BY THE REPOSITORY, INCLUDING COMPLETENESS OF RECORDS AND, WHERE NECESSARY, LEGAL VALIDITY OF SUBMITTED RECORDS.
 - CONFIDENTIALITY LAWS ARE NOT BREACHED THROUGH THE GRANTING OF SUCH ACCESS.

Rationale

DTCC agrees that it is vitally important that sources of operational risk are identified and controlled and that adequate business continuity plans are in place.

Furthermore, repository providers should ensure that they have appropriate policies and procedures to ensure that data remains confidential unless required to be disclosed by the competent regulatory authorities.

Given the central role envisaged for a trade repository, there are a number of additional features that are appropriate:

- A repository should run on a robust high-availability (i.e. >99.9%) operating infrastructure with documented capacity planning procedures and business continuity (“BCP”) plans in place and tested frequently. Such BCP plans should include the ability to operate the service (including staff) should the primary site becomes unavailable.
- IT analysis, development and testing should be undertaken to a standard befitting such a key infrastructural component – for example CMMI Level 3 or equivalent. It is vital that the information produced by a repository is of assured quality.
- Open access to other service providers. Such connectivity should be offered either free or at-cost, and specifications that allow such other service providers to develop such connections should be freely available and up to date at all times.

With regard to transparency and data availability, it is important for ESMA to ensure that the requirements for data are consistent with data protection laws within the jurisdictions of the reporting parties.

Additionally, the ESMA standards should ensure that repositories provide open access to market participants and other service providers. In the case of service providers, other than denial of access on risk-related grounds, access should be granted where the requestor is providing a service relevant to the repository or on behalf of one or more of the market participants that use that repository and who has given it access to their data, where the requestor meets the standards specified by the repository to ensure that the quality of services provided by the repository is not affected, and where the granting of access does not breach confidentiality laws.