

IMF STAFF COMMENTS ON
EU COMMISSION CONSULTATION ON
DERIVATIVES AND MARKET INFRASTRUCTURES

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<p><i>Please note that the views expressed in these comments are those of the IMF's staff, and not necessarily of its management or Executive Board.</i></p>
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1. **We welcome this opportunity to comment on this working document of the Internal Market and Services Directorate General of the European Commission.**¹ We support the European Commission's efforts to produce European legislation that will govern in the same way for all EU countries, the OTC derivatives markets, the activities of CCPs, linkages between CCPs, and the features of instruments to be cleared; taking into account the ESCB/CESR recommendations, based on the current CPSS/IOSCO Recommendations for CCPs. Those proposals to implement the principles agreed at G20 level in the European Union are a key step for strengthening the market infrastructure, and to move to a safer, more resilient, and dynamic global financial system. Indeed, the regulatory reforms need to move forward expeditiously after being adequately calibrated, and be introduced in a manner that accounts for the current financial conditions.

2. **The initiative to move OTC derivatives contracts to CCPs should lower systemic counterparty risk.** Indeed, the primary advantage of a CCP is its ability to reduce systemic risk through multilateral netting of exposures, the enforcement of robust risk management standards, and mutualization of losses resulting from clearing member failures. However, this

¹ These comments have been prepared by the staffs of the Legal and Monetary and Capital Markets Departments. They have benefited from input from the European Department.

will concentrate credit and operational risks on CCPs and thus magnify the systemic risk related to their own failure. It is then essential that they should be financially sound, subject to prudent risk management procedures and be effectively regulated and supervised. Soundly run and regulated CCPs will make derivatives markets safer, sounder, more transparent, and help mitigate the systemic risk associated with cascading counterparty failures.

Main points

3. **We are in broad agreement with the proposed measures that will better regulate the derivatives markets and the clearing activity in Europe.** However, while regulatory reforms are critical to building a more resilient financial system, sound regulation has to be accompanied by an effective supervisory regime. This consultation contains no reference to authorization and supervision of CCPs, since the Commission's services are discussing these institutional arrangements in other fora. However, the proposed measures could only be effective with the appropriate enforcement framework, and sufficient and skilled resources to implement them.

4. **Moving OTC derivatives contracts to CCPs will bring high transition costs due to the need to post large amounts of additional collateral at the CCPs.** This calls for a gradual transition. Indeed, a gradual phasing-in of central clearing is advisable to minimize potential shocks to dealer balance sheets from the need to post more collateral. One way of doing so would be to create a charge or levy tied to the risks that their derivative books impose on their counterparties, instead of an obligation to centrally clearing all eligible contracts at a given deadline. But if the European authorities judge that a mandate is the best solution, then it should be phased in gradually, especially at a time when the relevant institutions are already challenged to raise funds and capital in the post-crisis period.

5. **The reform proposals should be internationally coherent, in order to reduce the risk of disjointed policies, distorted capital flows and regulatory arbitrage.** Timely international coordination is crucial to ensure effective policy implementation. Europe is facing the challenge—and the opportunity—of creating stronger, better mechanisms that can take the European project to the next level. But it must also use its influence to ensure that globally consistent measures will emerge.

6. **Beside the measures discussed in the EU document, we believe that other key measures are necessary, as explained in Chapter 3 of the IMF April Global Financial Stability Report.²** There are the following:

² See International Monetary Fund, Global Financial Stability Report, Chapter 3 “*Making Over-the-counter Derivatives Safer: The Role of Central Counterparties*,” April 2010 <http://www.imf.org/external/pubs/ft/gfsr/2010/01/index.htm>.

- There should be a clear legal basis that assigns a lead authority to regulate CCPs, in order to ensure effective regulation and oversight. Indeed, there should be a clear legal basis that assigns explicitly the role of the regulator, prudential supervisor, and systemic risk overseer, with appropriate coordination and division of labor in light of their competences. Memoranda of Understanding are insufficient in the absence of legally comprehensive and enforceable rules.
- Regulatory authorities should ensure that a CCP complies with the current CPSS-IOSCO Recommendations for CCPs, then with the new CPSS-IOSCO standards for Financial Market Infrastructures (FMIs) when issued.
- Authorities should have in place contingency plans and appropriate powers to deal with a CCP failure. There is indeed a need for authorities to have contingency plans and appropriate powers to ensure that the financial or operational failure of a CCP does not lead to systemic disruptions in all related markets.
- Central banks should have the ability to supply emergency liquidity to systemically important CCPs in cases of extreme liquidity shortages. Any such emergency lending should be collateralized by the same high-quality liquid securities as those typically posted for central bank liquidity support. Also, it should not be done in any way that might compromise the central bank's monetary policy or foreign exchange policy operations.

I. CLEARING AND RISK MITIGATION OF OTC DERIVATIVES

Questions:

What are stakeholders' views on the clearing obligation, the process to determine the eligibility of OTC derivative contracts for mandatory clearing, and its application? Do stakeholders agree that access from trading venues to CCPs clearing eligible contracts should be guaranteed?

Clearing obligation

7. **We support the proposal that all European financial counterparties should clear the eligible derivatives contracts in the relevant CCPs**, even when they deal with third-country entities, since this is an efficient way to implement the principle agreed by the G20, namely that *“All standardized OTC derivatives should be [...] cleared through central counterparties by end-2012 at least”*.

Eligibility for the clearing obligation

8. **We support the two-pronged approach, combining initiatives from the CCPs and from the regulator, since it balances the interests of markets and regulators. To**

ensure that the clearing obligation for OTC derivatives contracts will reduce risk in the financial system, rather than increasing it, we also agree that a CCP must be authorized by the competent authority to clear a class of derivatives, which could then be added to the eligible derivative contracts' register by ESMA.

9. **However, clarity is missing on the criteria that ESMA will use to define which contracts should be eligible.** We believe that standardization is a necessary but not sufficient condition for CCP eligibility. Another important condition for central clearing is the regular availability of prices and enough market liquidity to assure that such prices are representative, plus the ability of the CCP to manage the relevant risks.

10. **To be able to evaluate the consequences of the new legislation, conducting an impact study would prove useful.** Indeed, the benefits of central clearing at both the individual counterparty and systemic levels can only be achieved if a critical mass of contracts is moved to CCPs. In that regard, there remain some potential challenges, including enhancing the degree of product standardization and liquidity. According to dealer and IMF staff estimates, the movement of OTC derivative contracts to CCPs will vary by type of product. For example, the vast majority of bilateral interest rate swap and index-based CDS contracts are expected to move to CCPs, as are most single-name CDS contracts. However, commodity-based, equity-based, and foreign exchange-based derivatives will be harder to move.

11. **An important criterion for evaluating the impact of these reform proposals should be that they achieve a balance between limiting systemic risk and maintaining the financial system's ability to innovate, to allocate capital effectively, and to pursue promising investment opportunities.**

Access to a CCP

12. **We agree that market participants should be given full access to a CCP to give full effect to the clearing obligation without creating a level playing field issue.** However, the choice of its clearing members (CMs) should stay a responsibility of the CCP, and should adhere to risk management considerations, as is proposed in section II 5. on participation requirements.

13. **For the sake of interoperability, we also support the proposal to force CCPs to accept eligible derivative contracts on a non-discriminatory basis, regardless of the venue of execution.**

14. **In addition, in order to reduce intraday risks, CCPs should ideally capture trades and assume the related counterparty risk at the time of execution.** This immediately reduces counterparty risk to the CMs because trades are immediately novated to and cleared by the CCP.

Non-financial undertakings

Question:

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

15. **Getting CCP buy-in from some end-users might be difficult, because many do not currently post any collateral or margin.** In some cases, they pledge other assets in lieu of cash and high-quality securities, and in other cases they only have to post collateral if certain credit-quality triggers (e.g., credit-rating downgrades) are tripped. Reasons for non-collateralization include transaction volumes that are not high enough to justify the operational costs of collateralization, and insufficient liquidity to manage daily collateralization adjustments. Liquidity is a particular concern for hedging transactions where the underlying cash flows being hedged occur years or even decades in the future.

16. **In this regard, some non-financial undertakings have expressed concerns that if such transactions are not “carved out” of requirements to be fully collateralized, some corporations will find it too expensive to hedge genuine commercial risks.** Hence, there does seem to be a case to “carve out” some “real” hedging transactions by end-users from requirements to move their contracts to CCPs. Consequently, the European proposal provides for some exemptions for hedgers who are non-financial undertakings by applying two thresholds: an information threshold and a clearing threshold. This has the merit of clarity because of the clear-cut distinction between financial and non-financial entities, which is defined in the EU legislation. This also allows a balance between the non-financial entities’ needs and the goal of financial stability.

17. **The main difficulty will come from defining both thresholds.** In this respect, it would be useful for the EU legislation to already set out some rules to refine what would be the “systemic relevance of the sum of net positions by counterparty per class of derivatives.” In addition, the risk exists that the boundaries between hedging and speculative purposes could be blurred or may be moving, and that commercial companies may become vehicles or targets for financial firms to do speculative transactions. Therefore, appropriate monitoring mechanisms need to be in place to report and sanction such type of behavior.

Risk mitigation techniques for non-cleared contracts

Question:

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

18. **We agree on the possible operational requirements set out for non-cleared contracts.** However, we do not understand the exception to the obligation to implement

electronic means to ensure effective confirmation of the terms of the contract, which comes from the phrase “to the extent possible”. Could the legislation be more precise on the circumstances that would prevent a financial counterparty or a non-financial counterparty exceeding the clearing threshold from having in place these electronic means?

19. **In addition to these operational requirements, we believe it essential to impose some kind of financial requirement on the non-cleared contracts to reflect the additional risk they bring.** It will already be the case with higher counterparty capital charges imposed on banks and dealers on bilaterally cleared transactions, compared to near-zero capital charges imposed on CMs on centrally cleared transactions. Not all transactions will be CCP eligible, and the non-cleared transactions should be made more expensive, reflecting their higher counterparty risks. For example, as a way of reflecting the risks that the large OTC derivative dealers’ books pose to their counterparties and to the financial system as a whole, a direct charge or “tax” on derivative payables (the amounts owed to others) could be considered.³ The “tax rate” would need to be calibrated to provide enough incentive to induce the dealers to lower their derivative payables in their OTC derivatives book—that is, their risk imposed on the rest of the system. Timing of the introduction of such charges would need to be carefully considered.

II. REQUIREMENTS FOR CENTRAL COUNTERPARTIES

Questions:

Do stakeholders share the general approach set out on organizational 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?

20. **The collapse of a CCP can have systemic consequences on the financial system, although such failures have been rare.** This underscores the importance of making sure that CCPs are subject to effective regulation and supervision, have strong risk management procedures in place, and are financially sound. To this end, CCPs should have appropriate risk modeling capabilities, be built on solid multilayered financial resources that are reinforced by financially strong CMs, have clear and legally enforceable layers of protection or financial support for covering losses given a CM default, and have developed contingency and crisis management plans, including for emergency liquidity support.

³ See IMF Working Paper 10/99 “*Collateral, Netting and Systemic Risk in the OTC Derivatives Market*,” by Manmohan Singh, 2010.

21. **In addition to the requirements set out in the EU consultation document, we believe that the EU legislation should clarify the legal and regulatory treatment of CCPs on issues such as their legal forms and charters, supervisory regime, insolvency regime, and emergency resolution process.**

Organizational requirements

22. **In addition to the proposed requirements, we were expecting some rule on the representation of CCP users.** Indeed, CCP governance arrangements should protect against compromising risk management and controls. The current CCP governance structures differ—some CCPs are for-profit entities with dispersed ownership, while others are effectively user-owned utilities. Although each type of governance structure has its strengths and weaknesses, the incentives for CCPs to increase their volume of business suggests that both models could lead to a loosening of risk management standards in order to either reduce the cost on the existing users or to attract new users. However, this tendency will be counteracted provided that users, who bear the risk of each other's default, have a sufficient voice in governance.

23. **We support the proposal to require at least one third of independent board members, but we suggest adding a requirement to implement dedicated governance arrangements for CCPs.** In most countries CCPs are set up as separate legal entities, although in some countries the CCPs are part of trading platforms or settlement systems. When CCPs are part of such larger groups there is a potential to create conflicts of interest and expose the CCPs to risks unrelated to their clearing operations. One way to mitigate these conflicts and protect CCPs from contagion risk is to legally ring-fence the CCP operations from the other activities.

Risk Committee, Conflicts of Interest and Outsourcing

24. **We agree with the proposed measures regarding the Risk Committee, Conflicts of Interest and Outsourcing, since they are in line with the international standards.**

Participation requirements

25. **Best practice CCP risk management starts with stringent requirements to become a CM in terms of sufficient financial resources, robust operational capacity, and business expertise.** These requirements should be clear, publicly disclosed, objectively determined, and commensurate with risks inherent in the cleared products and the obligations of CMs to the CCP. We believe that the proposals made by the EU meet these objectives.

Transparency

26. **In addition to what is proposed in the document, we suggest adding a transparency requirement on resolution arrangements.** One of the key lessons learned from the 2008 financial crisis is the importance of having transparent, ex ante resolution arrangements on how to close out positions. These arrangements include the auctioning of proprietary positions, the transfer of customer positions to the surviving CMs, and allocating the losses to the surviving CMs in a timely manner. The arrangements also include methods for determining the size and nature of position allocations, as well as measures to handle confidentiality and conflict of interest between the CCP and the CMs.

Segregation and portability

Questions:

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

27. **One of the key challenges to moving clients' positions to CCPs is to ensure them adequate protection from their CM failure.** Indeed, while moving positions to CCPs reduces their counterparty risk, clients also want to be assured that their CCP positions will be seamlessly ported to another CM in the event of the default of the CM through which they have established their positions. Many large customers also want to be assured that any collateral they post will be segregated from the collateral posted by their CM, and ideally segregated from the collateral posted by the CM's (and CCP's) other customers. Some CCPs are providing customer clearing services offering different levels of position portability and collateral segregation, but this area remains a work in progress. Consequently we welcome the rules proposed by the EU, which appear appropriate to improve the current situation.

28. **The segregation and protection of client and clearing member collateral need to be clear for various purposes,** including: disclosure and transparency of risk, pricing of risk, reuse of collateral, identification of collateral, enforcement of security interests, operational procedures, and the tracing of collateral.

29. **The effectiveness of such a portability regime requires strong legal underpinnings.** In particular:

- The laws applying to derivatives or to insolvent CMs should not limit the ability of customers to close out their position vis-à-vis the CM;
- The proceedings of the CCP should be carved out from general insolvency proceedings of insolvent CMs;
- Statutory provisions might be required to render portability enforceable even upon the commencement of an insolvency proceeding against the failed CM;

- Transfers organized by the CCP might need coordination with the supervisors in case the latter's approval is needed; and
- In some cases, private international law applicable to the transfer of contracts and related collateral should be harmonized.

30. **To the extent that omnibus accounts are less costly than individual accounts to maintain, customers face a trade-off between the safety inherent in the enhanced individualized segregation of their collateral and the costs associated with such additional protection.** The proposal to make segregated clients benefit from the 0 exposure value of the Capital Requirements Directive is an additional and powerful incentive toward individualized segregation.

Prudential requirements

Questions:

Do stakeholders share the general approach 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 sufficient to ensure access to central bank liquidity without compromising central banks' independence?

Default waterfall, initial margins, and default fund

31. **Initial margins collected from CMs against their specific positions should form the first buffer of protection against potential losses.** Initial margins serve to protect the CCP against contract nonperformance—that is, a CM default. They should be determined by the specific features of the contracts and current market conditions, risk-based, reviewed and adjusted frequently, and stress-tested regularly, even daily for highly volatile contracts. Initial margins should be in the form of cash, government securities, and possibly other high-quality liquid securities. By contrast, variation margins, which pass daily losses or gains from losers to gainers to ensure that market risk exposures are covered, should be in the form of cash and collected automatically on a daily basis (or intraday in some cases).

32. **The next buffer of CCP protection should come from the defaulting CM's contributions to a default fund.** This should be used when a defaulting CM's margins are insufficient to fulfill its payment obligations, to temporarily cover the CM's losses while its other assets are being liquidated, and to permanently cover losses if the CM is insolvent. Default fund contributions should be related to the CM's market position and the nature of its exposures, and be reevaluated regularly.

33. **Since CCPs will be authorized to establish more than one default fund for the different classes of instruments they clear, there needs to be disclosure, transparency and appropriate risk pricing of the ways different default funds work.** In particular, measures should be taken to ensure that counterparties clearly understand to which risks they are exposed depending on the class of instrument they deal with.

34. **It is crucial that CCPs balance the relationship between initial margining and a default fund.** For instance, a CCP that relies on a lower margining and a higher default fund may contribute to moral hazard by encouraging some CMs to take higher risks, since their losses are mutualized among all CMs. On the other hand, higher margining and a lower default fund reduces CMs' potential exposures to other CMs and may dilute their interest in ensuring that the CCP manages its risks robustly.

35. **If the defaulting CM's margin and guarantee fund contributions are insufficient, there should be several additional layers of protection.** These include a CCP-funded first-loss pool, the remaining guarantee fund contributions, and capital calls on non-defaulting CMs (which should be capped). The capital of the CCP is the last layer of protection after the capital calls. Protections for various types of liquidity problems should also be provided by emergency lines of credit and access to central bank liquidity facilities.

36. **Ultimately, the CCP should be managed so that it can survive an extreme but plausible stress event, such as simultaneous defaults of several large CMs.** The EU proposal envisages requiring CCPs to be able to withstand the default of the three clearing members to which they have the largest exposures. This goes further than the current international standards and probably future ones as well. This could disadvantage European CCPs and could lead financial entities to channel their derivatives transactions into third countries. Therefore, we suggest aligning the EU legislation with the future Standards for FMIs, which are currently being drafted by the CPSS/IOSCO, and will replace the current CPSS/IOSCO recommendations for CCPs.

Other risk controls and access to central bank liquidity

37. **To avoid systemic risk from the liquidity disruptions should it be unable to settle, a CCP should have sufficient liquidity to fulfill all of its cash obligations when due, under both normal and extreme but plausible circumstances.** We believe the EU proposals could be elaborated further on the liquidity issue and, in doing so, we suggest taking into account the draft Liquidity Risk Principle that the CPSS/IOSCO working group has prepared in the course of its drafting of the future Standards for FMIs, in particular the following key requirements that will apply in particular to CCPs:

- An FMI should have a robust liquidity management program that identifies the sources of liquidity risk, measures and monitors its liquidity needs under a range of scenarios, seeks to mitigate liquidity risks where feasible, ensures sufficient liquid

resources and sources of funding to cover those liquidity needs, and demonstrates the ability to access and apply those liquid resources in a manner that ensures timely settlement.

- An FMI's cash balances should be readily accessible on a same-day basis and invested or safe kept in a manner that bears little or no principal risk.
- An FMI should have pre-arranged and reliable liquidity and funding arrangements in place to provide same-day funding through prearranged liquidity lines, collateralized loans, currency swaps, asset purchases, repurchases, or pledges to allow the FMI to “liquefy” its non-cash assets to meet funding needs.
- An FMI should regularly test its access to its liquid resources and funding arrangements.
- In case of unforeseen and extreme circumstances, the FMI should have clear and ex ante established procedures to address the allocation of unexpected and uncovered liquidity needs among its participants.

38. **In addition, we believe that CCPs deemed to be systemically important should have access to emergency central bank liquidity.** However, any such emergency lending should be collateralized by the same high-quality liquid securities as those typically posted for central bank liquidity support. Also, it should not be done in any way that might compromise the central bank's monetary policy or foreign exchange policy operations. Indeed, for the sake of global financial stability, central banks should stand ready to provide emergency credit where the impact of a default would be particularly severe domestically, but also internationally. This would be different from giving permanent access to a standing facility, and could rather be assimilated to contingent arrangements to provide CCPs that have been classified as particularly critical with liquidity against collateral. It is essential that central banks take all the necessary measures to be able to react immediately in case of crisis. In particular, that means that they should identify in advance which CCPs to provide liquidity with and how, and that all the necessary legal and operational means should be in place before the crisis happens.

Settlement risk and investment policy

39. **We strongly believe that CCPs should be able to settle their transactions using central bank money so that there is no uncertainty about the finality of payment.**

40. **Furthermore, to avoid any counterparty risk, CCPs should be able to deposit cash collateral with the central bank.**

Additional question

41. **How do these prudential requirements, dedicated to CCPs, reconcile with those for credit institutions when the CCP has a banking license?** Should the CCP comply with both prudential requirements (those for credit institutions and those for CCPs), electing the most stringent ones when they cover the same type of issue (such as initial capital)?

Relations with third countries**Questions:**

Do stakeholders share the general approach 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?

42. **It is essential for the smooth functioning of the financial market that CCPs established in a third-country are allowed to provide clearing services to entities established in the EU**, provided that similar risk management criteria are fulfilled and that there is reciprocity.

43. **The extension of the clearing obligation to contracts cleared by third-countries' CCPs is essential to avoid regulatory arbitrage that could have a huge impact on the volume of contracts cleared in Europe.** However, this reinforces the need to allow third-country CCPs to provide clearing services established in the EU.

44. **In addition, given the global nature of financial markets, close cross-border coordination of regulatory and supervisory frameworks is required to avoid regulatory arbitrage and mitigate systemic risk and adverse spillover across countries.** The failure of a major CCP will not only affect the functioning of the European financial market, but it will also have a cross-border dimension due to the global nature of financial markets. Thus, authorities have an important role to play in ensuring that a CCP has adequate risk mitigation and management procedures and tools to protect the integrity of the markets more generally.

45. **Potential complications are introduced if CCPs clear transactions originated outside the local market, involve counterparties from different jurisdictions, or deal with collateral located or issued in different countries or denominated in different currencies.** Such internationally active CCPs require greater regulatory coordination than purely domestic ones. Regulatory frameworks need to ensure that sound and efficient CCP clearing mechanisms are established across jurisdictions, without unduly constraining multiple-currency or cross-border transactions. Furthermore, cross-border cooperation among regulators should hinder any CCP “racing to the bottom,” such as by loosening risk

management standards in pursuit of market-share gains. Such coordination should also aim to ensure that regulatory arbitrage opportunities are minimized.

III. INTEROPERABILITY

Question:

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

Interoperability between CCPs

46. **We agree that the right of interoperability should be reflected in EU legislation.** Indeed, while CCPs are thought to create significant benefits, the proliferation of disjointed CCPs may create potential problems. As the number of CCPs grows, the coordination cost involved in operating in multiple arrangements increases. Additional pools of collateral must be held and managed, and administrative costs increase as firms need to work with multiple infrastructures having potentially different legal environments, controls, compliance procedures, and processes. Ideally, the heterogeneity across CCPs should be decreased. This could be achieved in a number of ways, including CCP consolidation, processing harmonization, and interoperability between CCPs. In particular, it would be beneficial if more CCPs had the operational capacity to clear trades from multiple venues, and to allow CMs to benefit from cross-margining.

47. **It is not clear to us why the Commission services are of the view that the right to enter into an interoperability arrangement should at present be limited to cash instruments only.**

Managing risk arising from an Interoperability Arrangement

48. **However, establishing efficient linkages between CCPs across different jurisdictions and regulatory regimes has so far proven to be very complex, and may lead to risks to other CCPs from the CCP with the lowest risk management standards.** Interoperability may well expose CCPs to new or elevated levels of risks, including operational, legal, and counterparty risks. For these reasons, authorities should encourage the creation of links only if there is certainty as to the CCP's legal framework (including its insolvency regime) and close regulatory coordination between relevant authorities and a common, robust risk management methodology.

49. **To effectively achieve those objectives, interoperability has to be supported by robust legal underpinnings, from both a contractual and a statutory perspective.** Contractual frameworks should clearly establish the rights and obligations of all parties involved, in particular CCPs and CMs. It is especially important to understand whether, and which, interested parties are exposed to losses in the event of a failure of a CM or a linked

CCP. Other issues that can be solved through contract arrangements include dealing with (1) differing risk management practices and loss mutualization arrangements of CCPs; (2) differing mechanisms to assume counterparty risks; (3) the information needs of CCPs and CMs depending on the type of interoperability; and (4) the fungibility of cleared contracts for the CCPs. The laws governing the operation of CCP interoperability also need to provide robust statutory support. It is particularly relevant to establish clear and adequate rules on the insolvency and resolution of the CCPs involved, as well as on the treatment of the provision and segregation of collateral. These rules should specifically alleviate concerns that could arise from the treatment of inter-CCP margin requirements, which are applied by CCPs to cover counterparty risk to each other. For example, such concern could arise as to whether inter-CCP collateral would be subject to “claw-back rules,” whereby the defaulting CCP can claw back collateral from the non-defaulting one, and thus may not be enforceable by the non-defaulting CCP.

Approval of interoperability arrangements

50. **We support the need of prior approval of interoperability arrangements by all the relevant authorities, in order for them to take the appropriate measures to avoid adding an unacceptable layer of risks to the CCPs concerned and mitigate the contagion risk.**

IV. REPORTING OBLIGATION AND REQUIREMENTS FOR TRADE REPOSITORIES

Questions:

What are stakeholders' preferred options on the reporting obligation and on how to ensure regulators' access to information with trade repositories? Please explain.

Reporting obligations

51. **We agree that all OTC derivative transactions should be recorded and stored in regulated and supervised trade repositories, and detailed individual counterparty data should be available to all relevant regulators and supervisors.** We are less convinced this is needed for derivatives traded on exchange platforms since the relevant data are already available at the exchange platform level. Forcing financial counterparties to register their derivatives contracts in a trade repository in addition to them being registered on an exchange platform may be a counter-incentive to trade derivatives contracts on exchanges; therefore, we would not recommend it.

52. **The law should be clear about who (e.g., public, regulators, counterparties, market participants) is entitled to trade information, in what form (e.g., aggregate, individualized, disclosed in terms of category or type of risk), and in what time frame.**

53. **As for CCPs and for the sake of global consistency, we support option A where European financial counterparties would report their contracts to a registered trade repository, even for their non-EU derivative contracts.**

Requirements for registration of a trade repository

54. **For the same reasons we are in favor of option 2, where EU financial counterparties would continue using third-country trade repositories, provided that they are recognized by EU authorities.** As for CCPs, this is essential for the smooth functioning of the financial market, provided that there is information sharing commitment and some reciprocity arrangements.

Requirements for trade repositories

Questions:

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?

55. **We agree with the proposed requirements for trade repositories.** To achieve consistency between the EU and third-countries, it would be important to define an international framework for trade repositories, and a close coordination between all the authorities concerned is essential.

V. TECHNICAL REFERENCE GLOSSARY OF DEFINITIONS

Questions:

Do stakeholders agree with the definitions?

56. **We have no comment on the glossary.**