

clear to trade



**Eurex Clearing  
Response  
to**

ESAs' discussion paper on Draft Regulatory  
Technical Standards on risk mitigation for OTC  
derivatives not cleared by a CCP under the  
Regulation on OTC Derivatives, CCPs and Trade  
Repositories

Frankfurt am Main,  
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## **A. Introduction**

Eurex Clearing is a globally leading central counterparty clearinghouse (CCP) and the largest clearinghouse in Europe. Eurex Clearing is a subsidiary of Deutsche Börse Group providing central clearing services for cash and derivatives markets both for listed as well as certain over-the-counter (OTC) financial instruments. Eurex Clearing actively contributes to market safety and integrity with state-of-the-art market infrastructure as well as with industry leading risk management services for the financial industry. Customers benefit from a high-quality, cost-efficient and comprehensive trading and clearing value chain.

Eurex Clearing AG is a company incorporated in Germany and licensed as a credit institution under supervision of the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) pursuant to the Banking Act (Gesetz für das Kreditwesen). The Financial Services Authority (FSA) has granted Eurex Clearing status as a Recognised Overseas Clearing House (ROCH) in the United Kingdom.

Eurex Clearing welcomes the opportunity to comment on the ESAs' Joint Discussion Paper on Draft Regulatory Technical Standards on risk mitigation for OTC derivatives not cleared by a CCP under the Regulation on OTC Derivatives, CCPs and Trade Repositories issued in March 2012.

In our response, we focus on topics related to consistency, harmonization and integrity. The first part of the document contains general remarks we have on specific aspects of the joint discussion paper. The second part provides detailed answers to the questions posed by the ESAs.

## **B. General remarks**

Eurex Clearing strongly supports the attempts undertaken with EMIR, to strengthen the international financial regulatory system through improving over-the-counter (OTC) derivatives markets. In particular, it was agreed in the G20 to implement clearing for all standardized OTC derivative contracts through central counterparties by the end of 2012. EMIR is also concerned in defining frameworks for contracts and market participants not in scope of the clearing obligation.

Eurex Clearing appreciates the efforts of ESAs' Joint Discussion Paper to further elaborate especially on those questions related to OTC derivatives and market participants that are not in scope of the clearing obligation. Additionally, it is very well received that the ESAs endeavor creating consistency in international standards, as laid down in their Joint Discussion Paper.

Eurex Clearing believes that bilateral OTC derivatives should also in future form an important part of the global derivatives markets for market participants that cannot use standardized OTC contracts efficiently. Therefore, the focus on standards for bilateral risk mitigation techniques is highly important.

The Technical Standards should create a robust and cost efficient framework for non-standardized OTC contracts, but also provide economic incentives for a market-driven trend to use standardized and centrally-cleared OTC contracts when feasible. Furthermore, if OTC contracts cannot be cleared via CCPs, at least beneficial risk management aspects of CCPs should be leveraged for bilateral transactions. This would familiarize the market with various methods associated to central clearing, in order to provide for potential future clearing obligations.

## **C: Detailed answers to the questions**

### ***Collateral and capital requirements***

#### **Response to Question 1:**

**Q1: What would be the effect of the proposals outlined in this discussion paper on the risk management of insurers and institutions for occupational retirement provision (IORPs)?**

Answer:

We leave the detailed answer to this question for other market participants.

### ***Options for Initial Margins***

#### **Response to Questions 2 to 13:**

**Q2: What are your views regarding option 1 (general initial margin requirement)?**

Answer:

As general way forward, we support Option1. We believe that the ESAs have correctly depicted the interplay between initial margin and capital in paragraph 16. Especially the issues delineated in paragraph 17 clarify the need to further elaborate on the 'exchange of collateral'. The provision of initial margin is the best way forward to protect against counterparty default and to place the cost on the potential defaulter, as summarized in paragraph 23. The line of argumentation provided in paragraphs 21 to 23, as well as the resulting conclusion in paragraph 24, is fully supported.

**Q3: Could PRFCs adequately protect against default without collecting initial margins?**

Answer

We leave the detailed answer to this question for other market participants.

**Q4: What are the cost implications of a requirement for PRFC, NPRFC and NFCs+ to post and collect appropriate initial margin? If possible, please provide estimates of opportunity costs of collateral and other incremental compliance cost that may arise from the requirement.**

Answer

We leave the detailed answer to this question for other market participants.

**Q5: What are your views regarding option 2?**

Answer:

We do not support Option 2. While systemic relevance is of importance, option 2

results in a certain degree of asymmetry. It appears that the intention of ensuring protection of those deemed most systemically relevant, as pointed out in paragraph 25, is compromised. The disadvantageous position is outlined in paragraph 26 to 28. As a result, a scenario is sketched in which the stability of the financial system is endangered (paragraph 27), and the scope of avoidance of margin requirements (paragraph 28) is created. Both situations are unacceptable. For the similar considerations also Option 3 is not favored.

**Q6: How – in your opinion - would the proposal of limiting the requirement to post initial margin to NPRFCs and NFCs+, impact the market / competition?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q7: What is the current practice in this respect, e.g. If a threshold is currently in place, for which contracts and counterparties is it used? Which criteria are currently the bases for the calculation of the threshold?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q8: For which types of counterparties should a threshold be applicable?**

Answer:

Given the explanation in paragraph 34, we do not think that the threshold approach is adequate. As we answered already to question 5, we do not support Option 3 as it might create disruptive effects for counterparties in case thresholds are exceeded.

**Q9: How should the threshold be calculated? Should it be capped at a fixed amount and/ or should it be linked to certain criteria the counterparty should meet?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q10: How – in your opinion - would a threshold change transactions and business models?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q11: Are there any further options that the ESAs should consider?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q12: Are there any particular areas where regulatory arbitrage is of concern?**

Answer:

In general, we are concerned with elusion as already understood and pointed out by the ESAs. Paragraphs 28 and 34 rightly point out the weaknesses of calibration. Combined with section IV.7 and IV.9, it is important that adequate measures are also taken within, and outside the EU. Also, requirements pointed out on a global level, as for example by CPSS-IOSCO should be taken into consideration, in order not to open doors to arbitrage.

**Q13: What impacts on markets, transactions and business models do you expect from the proposals?**

Answer:

Overall, as emphasized before already, Option 1 appears to be the right way forward. Thus, transactions would receive the right basis, and markets would become safer and more transparent, as a result. Furthermore, we believe, market participants would be able to familiarize with the system of initial and variation margin in an early stage already, and would be used to it, when a clearing obligation would follow at a certain time in the future.

***Variation Margin***

**Response to Questions 14 and 15:**

**Q14: As the valuation of the outstanding contracts is required on a daily basis, should there also be the requirement of a daily exchange of collateral? If not, in which situations should a daily exchange of collateral not be required?**

Answer:

Ideally, daily exchange of collateral should be required. However, if this should not be possible, exposures/ risks should be appropriately managed.

**Q15: What would be the cost implications of a daily exchange of collateral?**

Answer:

We leave the detailed answer to this question for other market participants.

## ***Initial Margin Calculation***

### **Response to Questions 16 to 26:**

**Q16: Do you think that the “Mark-to-market method” and/or the “Standardised Method” as set out in the CRR are reasonable standardised approaches for the calculation of initial margin requirements?**

Answer:

We assume that under "Mark-to-Market method for IM", the question relates to Current Exposure Method for IM as described in the consultative document for Capitalization of Bank Exposures to CCPs.

CEM method is too simplistic to always reflect an adequate level for initial margins. Especially for large diversified portfolios the risk numbers are flawed. The same though also holds for the 'standardized method'. Although we share the concerns on internal models as laid down in paragraph 40 by the ESAs, our view is that adequate reflection of risks in initial margin can be best achieved by using Internal Models.

**Q17: Are there in your view additional alternatives to specify the manner in which an OTC derivatives counterparty may calculate initial margin requirements?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q18: What are the current practices with respect to the periodic or event-triggered recalculation of the initial margin?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q19: Should the scope of entities that may be allowed to use an internal model be limited to PRFCs?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q20: Do you think that the “Internal Model Method” as set out in the CRR is a reasonable internal approach for the calculation of initial margin requirements?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q21: Do you think that internal models as foreseen under Solvency II could be applied, after adequate adjustment to be defined to the internal model framework,**

**to calculate initial margin? What are the practical difficulties? What are the adjustments of the Solvency II internal models that you see as necessary?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q22: What are the incremental compliance costs (one-off/on-going) of setting up appropriate internal models?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q23: To what extent would the „mark-to-market method“ or the „standardised method“ change market practices?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q24: Do you see practical problems if there are discrepancies in the calculation of the IM amounts? If so, please explain.**

Answer:

We leave the detailed answer to this question for other market participants.

**Q25: Would it be a feasible option allowing the party authorised to use an internal model to calculate the IM for both counterparties?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q26: Do you see other options for treating such differences?**

Answer:

We leave the detailed answer to this question for other market participants.

***Segregation and Re-use***

**Response to Questions 27 to 31:**

**Q27: What kinds of segregation (e.g., in a segregated account, at an independent third party custodian, etc.) should be possible? What are, in your perspective, the advantages and disadvantages of such segregation?**

Answer:

The arguments developed in paragraphs 43 to 45 provide a very good outline of the



issues at hand. Particularly paragraph 43 describes a good approach. We can imagine that a flexible set-up on how to address the issues might be necessary. This set-up however should ensure that collateral is legally segregated and portable in case of default.

**Q28: If segregation was required what could, in your view, be a possible/adequate treatment of cash collateral?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q29: What are the practical problems with Tri-Party transactions?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q30: What are current practices regarding the re-use of received collateral?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q31: What will be the impact if re-use of collateral was no longer possible?**

Answer:

We leave the detailed answer to this question for other market participants.

***Eligible Collateral***

***Response to Questions 32 to 35:***

**Q32: What are, in your view, the advantages and disadvantages of the two options?**

Answer:

ESMA's criteria based collateral requirements as outlined in the ESMA Discussion Paper are a good starting point. However, we can see the need for non-CCP cleared contracts to enjoy a certain degree of flexibility, as pointed out in Option 2 (paragraph 48). However, a disadvantage of this Option 2 is that risks might not be adequately reflected by the counterparties, e.g. haircuts have not been appropriately applied.

**Q33: Should there be a broader range of eligible collateral, including also other assets (including non-financial assets)? If so, which kind of assets should be included? Should a broader range of collateral be restricted to certain types of counterparties?**

Answer:

The considerations of ESMA taken in their discussion paper on collateral could be taken as a basis. Exemptions should only be allowed in clearly defined and reasoned cases, subject to approval by the national competent authority.

**Q34: What consequences would changing the range of eligible collateral have for market practices?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q35: What other criteria and factors could be used to determine eligible collateral?**

Answer:

We leave the detailed answer to this question for other market participants.

***Collateral Valuation/ Haircuts***

***Response to Questions 36 to 40:***

**Q36: What is the current practice regarding the frequency of collateral valuation?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q37: For which types of transactions / counterparties should a daily collateral valuation not be mandatory?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q38: What are the cost implications of a more frequent valuation of collateral?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q39: Do you think that counterparties should be allowed to use own estimates of haircuts, subject to the fulfilment of certain minimum requirements?**

Answer:

In principle, collateral haircuts as outlined in Basel III should be applied as a minimum. In case own models are used, the risk needs to be appropriately addressed.

Internal models used should be subject to approval by the national competent authority.

**Q40: Do you support the use of own estimates of haircuts to be limited to PRFCs?**

Answer:

We leave the detailed answer to this question for other market participants.

***Transactions with counterparties outside the EU/ Risk management procedures, operational process for the exchange of collateral and minimum transfer amount***

***Response to Questions 41 to 44:***

**Q41: In your view, what criteria and factors should be met to ensure counterparties have a robust operational process for the exchange of collateral?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q42: What incremental costs do you expect from setting up and maintaining robust operational processes?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q43: What are your views regarding setting a cap for the minimum threshold amount? How should such cap be set?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q44: How would setting a cap impact markets, transactions and business models?**

Answer:

We leave the detailed answer to this question for other market participants.

### ***Intra-group Exemptions***

#### **Response to Questions 45 and 46:**

**Q45: In your views, what should be considered as a practical or legal impediment to the prompt transfer of own funds or repayment of liabilities between the counterparties?**

Answer:

We leave the detailed answer to this question for other market participants.

**Q46: What is the current practice regarding the collateralisation of intra-group derivative transactions?**

Answer:

We leave the detailed answer to this question for other market participants.

### ***Cost-benefit Analysis***

#### **Response to Questions 47:**

**Q47: What is the impact of the presented options on the capital and collateral requirements of the counterparties affected by the relevant provisions and the span of time necessary to comply with the Regulation?**

Answer:

We leave the detailed answer to this question for other market participants.

## **C. Closing**

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

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