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**ESCB/CESR Public Consultation**  
*(ref: CESR/09-302)*

**Draft Recommendations for CCPs revised for  
CCPs clearing OTC derivatives**

**French Market Position**

1. Association française des marchés financiers, AMAFI, has more than 120 members representing over 10,000 professionals who operate in the cash and derivatives markets for equities, fixed-income products and commodities. Nearly one-third of the members are subsidiaries or branches of non-French institutions.

The French Banking Federation, FBF, is the professional body that represents the banking sector in France, i.e. more than 500 cooperative, savings and commercial banking establishments.

The French Association of Securities Professionals "AFTI" has over more than 100 members, all players in the securities market and post-trade activities: banks, investment firms, market infrastructures, issuer services. The AFTI aims to promote and represent their trade activities on the French marketplace and across the European Union.

2. The three associations above welcome the opportunity to comment on the CESR consultation on draft recommendations for Central Counterparties revised for CCPs clearing OTC derivatives. These comments are in addition to the comments previously made by AMAFI, FBF and AFTI on CESR public consultation (ref: CESR/08-749) which are still relevant.

Before commenting the specific recommendations proposed by ESCB/CESR in the consultation paper AMAFI, FBF and AFTI would like to emphasise some general issues, some of them being developed in more details in the specific answers.

## **I) General comments**

- ***We would like to underline the fact that, in Europe, clearing services are currently provided by CCPs according to two different business/legal models.***

After the implementation of MiFID, new CCPs have been created. Introducing in Europe the "non for profit model", these new CCPs have implemented procedures aimed to mutualise risks among their participants. In this model, the default of one of their participants is supported by the others and not by the CCP itself (which does not have any liability in case of default).

Moreover, in most of the cases, these CCPs provide their services according to a legal environment under which they do not need to be well capitalised, to be granted to a specific (banking) status or to obtain a prior written approval from their regulators before modifying their clearing rules. In this legal environment, collateral deposited to the CCP are not transferred outright (full ownership transfer) but subject to a pledge and a right of re-use.

In the absence of regulatory instrument at European level (such as a directive on clearing and settlement activities) and in the context of the financial turmoil, we think that the ESCB/CESR recommendations (hereinafter referred to as the "Recommendations") should, at least, ensure:

- (i) **that all CCPs providing clearing services respect a high standard of risk management, notably by offering a guarantee in case of default of a participant and;**
- (ii) **a level playing field in the activities of CCPs throughout Europe.**

- ***Considering the specificities of OTC derivatives, which could imply higher risk than on-exchange traded financial instruments and be less liquid than the latter, the particular market infrastructure functions of a CCP clearing OTC derivatives should be considered more precisely. Therefore, we should wait before promoting interoperability between CCPs clearing OTC derivatives.***

**At this stage, we do not think that Recommendations should promote the interoperability between CCPs.** Indeed, taking into account the fact that a very limited number of interoperable links have been implemented since the signature of the code of conduct, we think that at this stage we cannot determine (i) whether such interoperability would not increase the systemic risk and (ii) if, in the specific area of the OTC derivatives, it will not lead to new legal and operational barriers (such as, for example, regarding disclosure of information between warehouses). Therefore, we think that the Recommendations should focus on the main points which are mandatory to allow OTC derivatives to be cleared before going forward on interoperability.

- ***Each CCP must have intraday/overnight access to central bank money in the currency it operates in and a CCP should not be allowed to take credit risk and liquidity risk.***

**3.** A CCP should always be in a position to rapidly and securely obtain the necessary liquidity for it to limit systemic risk, as provided by the European monetary policy. In the event of a major financial crisis in Europe, European central banks had a major role to play in order to solve the crisis.

In case of default of one of its participants, the CCP needs to be able to access to the liquidity provided by a central bank as rapidly as possible (on an intraday or overnight basis). In this context, the CCP should have a direct link with the central bank and should be under its supervision.

**As soon as the transactions deal with euro-based underlying, we are convinced that any CCP for OTC derivatives (CDS notably) should be located within the Euro-zone to be able to access to the liquidity provided by the ECB as rapidly as possible (on an intraday or overnight basis).**

Furthermore, for systemic risk mitigation reasons, we think that any re-use of the collateral deposited with the CCP by its participants should be made following restrictive conditions (possibility for re-use only for (i) the purpose of intraday liquidity management to be provided by central banks and (ii) investment in secure assets such as government bonds).

➤ ***The relative illiquidity of certain contracts leads to important differences in risk management. Those differences should be reflected in specific Recommendations***

4. **We welcome the statement that the risks in clearing OTC derivatives do not significantly differ in nature from those of clearing on-exchange transactions** (even if ISDA agreements can force CCPs to follow certain procedures), **but that the greater complexity of OTC derivatives and the relative illiquidity of certain contracts can lead to differences in risk management** (*Introduction, par. 4*). The possible illiquidity of certain OTC derivatives should be taken into account, given that illiquidity of the traded assets implies that the CCP should absorb not only the counterparty risk (default of a participant) but also a higher liquidity risk.

5. **We are of the opinion that it should be made clear which products are “eligible” for clearing** taking into account, notably the above-mentioned illiquidity risk as well as the counterparty risk. We therefore propose that a recommendation be inserted on eligibility criteria of OTC derivatives for CCP clearing. Those eligibility criteria should at least:

- ✓ be predefined by the CCP;
- ✓ be made public by the CCP;
- ✓ be based notably on the liquidity of the relevant OTC derivative.

We are of the opinion that all the CCPs should always clearly set in their clearing rules under which conditions they could cease to clear some OTC derivatives, given the fact that the market integrity should always prevail.

6. Given the amount at stake (the amount traded using OTC derivatives are much more important than the amount traded on the regulated markets/MTFs) and that the default of a participant could have consequences on the other participants, **we think that the membership conditions of the CCP should be particularly stringent**. We therefore propose that a recommendation be inserted related to membership of CCP of OTC derivatives. Those conditions should at least comprise:

- ✓ the participation to a guarantee fund, distinct from any other guarantee fund, created by each CCP for the clearing of transactions on OTC derivatives;
- ✓ status requirements to membership. An entity should only be eligible to membership if it has the status of Investment Services Provider or Credit Institution;
- ✓ particular high capital requirements should be fulfilled with (*Recommendation 2, C, al. 3*);
- ✓ when the participants benefit from a credit rating, the latter should be taken into account (*Recommendation 2, C, al. 3*), for their admission and the amounts of margin they pay and their participation to the OTC derivatives guarantee fund.

7. The membership conditions should be defined and published by the CCP. They should be non-discriminatory.

## II) Draft Recommendations for Central Counterparties

Please find hereinafter our comments on the draft Recommendations.

### Introduction

8. **Par. 2:** Among the enumeration of issues, the Recommendations are concerned with the **protection of non-clearing participants**. Although we agree that this is a realistic concern, we would like to make the following observation.

The protection of non-clearing participants, notably in the case of default of a participant, is linked to the **default of the CCP**. Participants who take a counterparty risk on the CCP (the "central" counterparty), should be guaranteed that the CCP cannot be in default. In a context where there are two different business/legal models in Europe (see first point of the general comments), we think that Recommendations should ensure that the CCPs cannot be in default (by imposing, notably, that they are well capitalised, that they need to be granted a dedicated status and that they can access on an intraday/overnight basis to the liquidity provided by the ECB).

9. **Par. 8:** Concerning **warehouses**, we much appreciate that CESR will study the usefulness of such a facility and touches upon certain concerns related to warehouses. In addition to the concerns already expressed in the consultation document, we are of the opinion that there should not be more than one warehouse per type of OTC derivative, which might imply warehouses specialised per product. In addition, where a warehouse contains the primary record of Europe based contracts, the warehouse should be based in Europe and regulated by a European regulator.

### Recommendation 1: Legal Risk

10. **B, par. 3** provides for situation where a CCP participant, a linked CCP or an interoperable CCP or a participant in a linked or interoperable CCP defaults or becomes insolvent. **The situation of default of the CCP should also be provided for in the rules, procedures and contracts between the CCP and its participants.**

11. **Par. B4, C8, C9 and C12** contain references to **conflict of law issues**. We welcome the concern that **the same law should apply to the various aspects of the relation between the CCP and its participants** (including contract, system, proprietary aspects). However, **choice of law is not an option for the determination of the law applicable to the system and the proprietary aspects of securities held on a participant's account in the system** (*Recommendation 1, al 9*). Therefore, references to a law "chosen to govern the proprietary aspects of securities cleared by the CCP or taken as collateral" should be altered. Since derivatives are also contracts and that they are not registered into account, we do not see what is meant with "proprietary aspects" of OTC derivatives.

The European Union made a clear decision on how to achieve that the same law applies to the various aspects of the relation between (i) an infrastructure and its participants or (ii) participants and their clients: only the law applicable to the contract is subject to a choice. We have no objections against the information that a CCP may provide to its participants in relation to the applicable law (*Recommendation 1, al. 12*), as long as that information does not result from a free choice by the CCP.

12. **Recommendation C, par. 9** provides for the possibility, for the CCP to rehypothecate collateral. **This should be limited (i) in the context of investment in secure assets such as**

**government bonds and (ii) to re-use in favour of a central bank for the purpose of obtaining intraday liquidity.**

13. Recommendation C, par. 10 : We think that any CCP for OTC derivatives established in the EU should comply with the Settlement Finality Directive as soon as it provide clearing services.

#### Recommendation 2: participation requirements

14. **B, par. 3**, concerning the **conditions of access to CCP**. We disagree with the fact that risk-related criteria should be the only reasons for denial of access. It is our opinion that access could be denied also because of legal, technical and operational reasons and compliance, including unenforceability of CCP clearing provisions upon remote participants, insufficiency of qualified staff, etc.

#### Recommendation 4: margin requirements

15. **B, par. 3**: The terms "**highly liquid instruments**" should be defined in the Recommendations or in each CCPs clearing rulebook (*also Recommendation 4, C, par. 6*).

16. **C, par. 2**: Last sentence, we advocate the deletion of the words "to an appropriate extent". **Margin calculation requirements should always and continuously be made available to CCP participants and future participants.**

#### Recommendation 5: other risks control

17. We welcome the Recommendation on **stress test**, but stress tests help in avoiding CCP defaults, they do not participate in the resolution of a CCP's default. We insist on the need for a **recommendation addressing the particular case of a CCP's default**.

18. Concerning **credit and liquidity risk managed by the CCP**: is it not contradictory to provide for clear and precise Recommendations concerning the default of a CCP participant and to allow the CCP to obtain liquidity from entities which are similar to the CCP participants (*Recommendation 7, C, 4*)? **Credit lines should only be obtained from Central Banks** in the currency in which the CCP operated (*Recommendation 5, C, par. 11 and Recommendation 6, C, par. 6*).

19. **C, par.7 and 8. The funds deposited in the CCP's clearing fund should only be invested in secure assets such as government bonds**. Moreover, we are of the opinion that the CCP's own assets serving the purpose of the fulfilment by the CCP of its obligations in case of a participant's default should not be invested. Once again, we are of the opinion that the CCP should have a sufficient capital to fulfil its obligations in case of default of one or several of its clearing members. In this context, the mere adequacy of the calculation of resources (*par. 8*) is insufficient.

20. **C, par. 10**. We strongly support the creation of a **dedicated clearing fund**.

#### Recommendation 6: default procedures

We do agree with this Recommendation.

#### Recommendation 7: custody and investment risk

21. This Recommendation contains provisions on the investments conducted by the CCP, the CCP's investment decisions and requirements. **Investment of collateral provided to the CCP should be limited to investment in secure assets such as government bonds.** Collateral serves the limitation of market risk and counterparty risk. Investment of collateral by the CCP implies additional types of risk. The Recommendation should focus on the fact that **securities collateral should be segregated and cash collateral provided to CCPs, which are not credit institutions, should be held with the relevant Central Bank.**

#### Recommendation 8: operational risk

22. **C, par. 6: External control** should be compulsory. The Recommendation currently provides that it should "be considered", which is insufficient.

#### Recommendation 14: transparency

We do agree with this Recommendation.

#### Recommendation 15: regulation, supervision and oversight

We do agree with this Recommendation.



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