**OTC\_Counterparty\_Repository**

**ID:** 378 **Code:** COM (2010) 484 2010/0250/COD **Type:** Regulation **Date of Proposal:** 15.09.2010 **Current Status:** Commission position on EP amendments on 1st reading (29.3.2012)

**Title:** Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on OTC derivatives, central counterparties and trade repositories

**Identified Commission Official:** DG Internal Market and Services

**Objective:** To increase transparency in the OTC derivatives market and to make it safer by reducing counterparty credit risk and operational risk in the light of OTC derivatives being responsible for financial crisis.

**Background**: A derivative is a contract between two parties linked to the future value or status of the underlying to which it refers (e.g. the development of interest rates or of a currency value, or the possible bankruptcy of a debtor). An over-the-counter (OTC) derivative is a derivative not traded on an exchange but instead privately negotiated between two counterparts.

Currently, reporting of OTC derivatives is not mandatory. As a result, policy makers, regulators but also market participants do not have a clear overview of what is going on in the market. In its draft regulation, the Commission proposes that information on OTC derivative contracts should be reported to trade repositories and be accessible to supervisory authorities. The new European Securities and Markets Authority (ESMA) will be responsible for the surveillance of trade repositories and for granting / withdrawing their registration. More information will also be made available to all market participants. The Commission also proposes that standard OTC derivative contracts be cleared through central counterparties (CCPs). CCPs are entities that interpose themselves between the two counterparties to a transaction and thus become the 'buyer to every seller', as well as the 'seller to every buyer'. This will prevent the situation where a collapse of one market participant causes the collapse of other market participants, thereby putting the entire financial system at risk. Beside the increase of transparency, the proposal also intends to reduce counterparty credit risk by introducing stringent rules on prudential (e.g. how much capital they need hold), organisational (e.g. role of risk committees) and conduct of business standards (e.g. disclosure of prices) for CCPs; mandatory CCP-clearing for contracts that have been standardised (i.e. they have met predefined eligibility criteria) and risk mitigation standards for contracts not cleared by a CCP (e.g. exchange of collateral). With reduce of operational risk, which is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events, the proposal requires the use of electronic means for the timely confirmation of the terms of OTC derivatives contracts. This allows counterparties to net the confirmed transaction against other transactions and ensure accurate book keeping.

**Consultation:** Since October 2008, the extensive consultations took place with stakeholders in form of bilateral and multilateral meetings, two public consultations and a conference. Initially the Commission services’ attention focused on the Credit Default Swap (CDS) market which was at the centre of attention with Bear Sterns and Lehman's. The Commission established the Derivatives Working Group (DWG) that included representatives from the financial institutions that committed to clear European referenced CDS by July 2009, representatives from central counterparties, trade repositories and other relevant market participants and from relevant European (ECB, CESR, CEBS and CEIOPS) and national (AMF, BaFin and FSA) authorities. The Commission held separate, ad-hoc bilateral and multilateral meetings with a large number of stakeholders in the CDS market.

Following industry compliance with the above-mentioned commitment and to prepare legislative measures, the Commission formed a Member States Experts Working Group on Derivatives and Market Infrastructures. It discussed regulatory approaches with experts representing Member States, the ECB, CESR and CEBS. It held a series of meetings from January to July 2010.

The Commission has also gained valuable information by participating in various international fora, in particular the OTC Derivatives Regulators Group and the Basel Committee's Risk Management and Modelling Group. The Commission has recently also gained observer status on the steering committee of the joint CPSS-IOSCO working group that is currently reviewing the recommendations for CCPs and preparing recommendations for trade repositories. In addition, the Commission has engaged in frequent dialogue with non-EU authorities, in particular US authorities (the CFTC, the SEC, the Federal Reserve Bank of New York and the Federal Reserve Board and the US Congress) and is co-chairing a work stream of the Financial Stability Board (FSB) focusing on addressing the challenges related to the implementation of the reporting, clearing and trading obligations agreed at G20 level.

In parallel with the publication of the first Communication, DG MARKT launched a public consultation from 3 July to 31 August 2009. The Commission services received 111 responses. This was followed by a major conference in Brussels, on 25 September 2009. Three panels of academics, industry representatives and regulators, coming from the EU and the US, presented their views on the need (or lack thereof) to reform the OTC derivatives market to an audience of more than 400 participants and answered their questions.

A second open consultation was organised from 14 June to 10 July 2010 to obtain feedback from interested stakeholders on the contours of the legislative measures. The Commission services received 210 responses, which were for the most part supportive of the suggested reforms.

## Issues: Reporting of all derivative contracts to trade repositories (i.e. central data centres) and the clearing of standardised OTC derivative contracts through central counterparties (CCPs).

**Frames**:  1) Financial stability concerns; preventing the default of one market participant causing the collapse of other market players, thereby putting the financial system at risk.

**Other Information:** In September 2009, at the G-20 Pittsburgh Summit, the leaders of the 19 biggest economies in the world and the EU agreed that *"all standard OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest."* Furthermore, they acknowledged that *"OTC derivative contracts should be reported to trade repositories and that non-centrally cleared contracts should be subject to higher capital requirements."* Member States undertook at the June 2010 European Council to conclude all negotiations relating to G20 commitments on financial reform by end of 2011. In line with G20 commitments, the new rules should be fully in place and operational by the end of 2012.

According to media reports Sarkozy, Merkel and Juncker gave their backing to efforts under way in the Commission to push derivatives trading onto exchanges, or through central counterparty clearing, so that it can be better monitored.