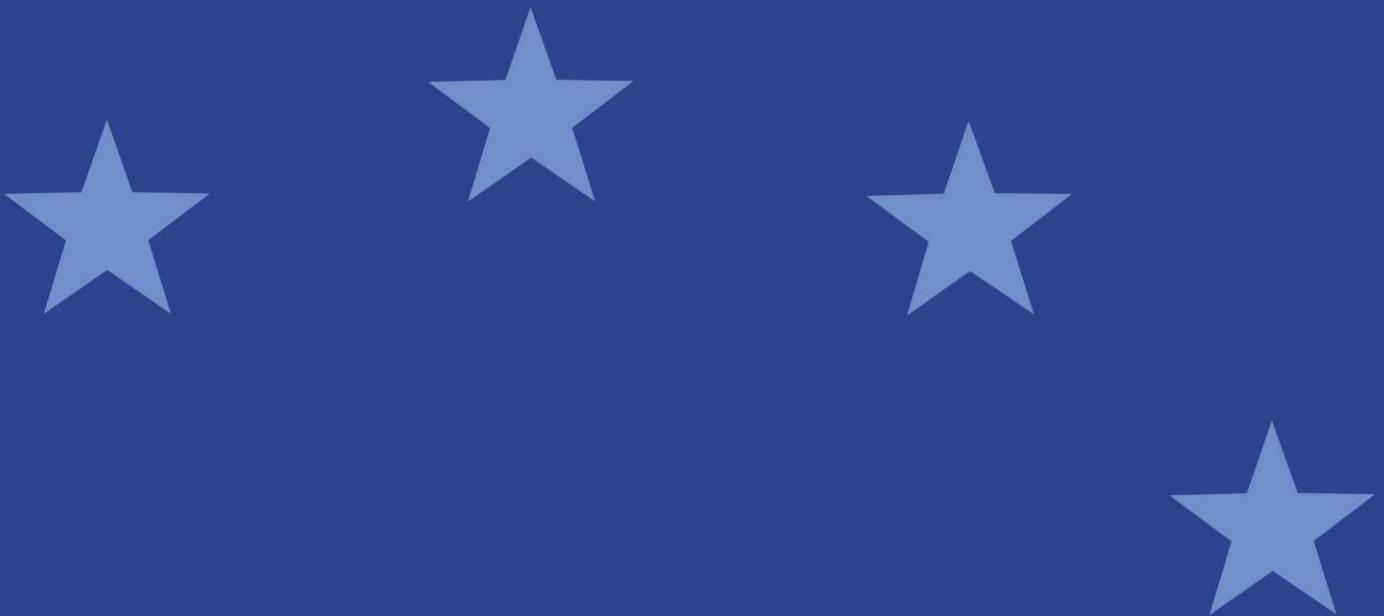




European Securities and  
Markets Authority

## Discussion Paper

Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and  
Trade Repositories



## **Responding to this paper**

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

- indicate the specific question to which the comment relates;
- respond to the question stated;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **19 March 2012**.

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading 'Consultations'.

## **Publication of responses**

All contributions received will be published following the close of the consultation period, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA's Board of Appeal and the European Ombudsman.

## **Data protection**

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading 'Disclaimer'.

## **Who should read this paper**

All interested stakeholders are invited to respond to this discussion paper. In particular, responses are sought from financial and non-financial counterparties of OTC derivatives transactions, central counterparties (CCPs) and trade repositories (TRs).

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## Acronyms Used

CCPs	Central Counterparties
TRs	Trade Repositories
RTS	Regulatory Technical Standards
ITS	Implementing Technical Standards
ESAs	European Supervisory Authorities
EBA	European Banking Authority
EIOPA	European Insurance and Occupational Pension Authority
ESMA	European Securities and Markets Authority
ESCB	European System of Central Banks
EMIR	European Market Infrastructures Regulation – Regulation of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories – also referred to as “the Regulation”.

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## **I. Executive Summary**

### **Reasons for publication**

This discussion paper seeks stakeholders' views on the regulatory and implementing technical standards ESMA is required to draft under the Regulation of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories as agreed at the Trilogue meeting of 9 February 2012 (the Regulation).

The input from stakeholders will help ESMA in the development of the relevant technical standards to be drafted and submitted to the European Commission for endorsement in the form of Commission Regulations, i.e. a legally binding instrument directly applicable in all Member States of the European Union. One essential element in the development of draft technical standards is the analysis of the costs and benefits that those legal provisions will imply. Input in this respect and any supportive data will be highly appreciated and kept confidential where required.

### **Contents**

This discussion paper follows the structure of EMIR, with the first section focusing on OTC derivatives and in particular the clearing obligation, risk mitigation techniques for contracts not cleared by a CCP and exemptions to certain requirements. The second part focuses on CCP requirements, where a number of provisions need to be specified through technical standards. The third part deals with trade repositories and in particular the content and format of the information to be reported to trade repositories, the content of the application for registration to ESMA and the information to be made available to the relevant authorities.

### **Next steps**

ESMA is organising a public hearing before the end of the consultation period for this discussion paper, to give an opportunity to interested stakeholders to express their preliminary views and to get early feedback.

As provided for by Regulation No 1095/2010 of the European Parliament and Council establishing ESMA, a public consultation will be conducted on the draft technical standards before they are submitted to the European Commission for endorsement in the form of Commission Regulations. According to ESMA decision ESMA/2011/BS/4a on the procedure for developing and adopting draft technical standards and guidelines, the consultation paper will include the actual legal text of the provisions constituting the draft technical standards, an explanation of the measures adopted and a cost-benefit analysis. Therefore, following this discussion paper and on the basis of the relevant input received, ESMA will prepare draft technical standards to be included in the consultation paper. The date of publication of such consultation paper and the commenting period will depend on the date of publication of the Regulation in the Official Journal. It is expected to take place around summer 2012.

EBA, EIOPA and ESMA are also expected to issue in the coming weeks a joint discussion paper on regulatory technical standards they are required to draft jointly. This joint discussion paper will cover risk mitigation techniques for OTC derivatives that are not cleared by a CCP, notably on capital requirements and exchange of collateral to cover the exposures arising from those transactions and on operational processes



for the exchange of collateral, minimum transfer amount and intra-group exemptions. This joint discussion paper will be available on the website of the three ESAs.

EBA is also expected to issue in the coming weeks a discussion paper on draft regulatory technical standards on capital requirements for CCPs. This discussion paper will be available on the EBA website.

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## II. Introduction

1. At the trilogue meeting of 9 February 2012, the European Parliament, the Council and the European Commission reached a political agreement on the Regulation of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories (the Regulation, or EMIR). This discussion paper is based on the version of the text of the Regulation following such agreement.
2. The Regulation introduces provisions to improve transparency and reduce the risks associated with the OTC derivatives market and establishes common rules for central counterparties (CCPs) and for trade repositories (TRs). It has been identified that common rules are required in the case of CCPs in view of the shift of risk management from a bilateral to a central process for OTC derivatives and in the case of trade repositories because of the increase in information that needs to be reported to them. The Regulation delegates or confers powers to the Commission to adopt regulatory technical standards (RTS) and implementing technical standards (ITS) on a number of areas (see Annex IV for the legal mandate). This discussion paper covers the draft RTS and ITS which ESMA is expected to develop.
3. ESMA's views as presented in this discussion paper are of a preliminary nature and aims at gathering stakeholders' opinions at an early stage of the process. Some of the technical standards are more developed than others. This reflects the level of maturity and non-controversial aspects of the EMIR text and the time that ESMA had at its disposal to conduct its analysis on a stable part of the primary legislation. Views and preliminary considerations expressed in this discussion paper will not bind in any way ESMA in the future development of the draft technical standards.
4. One essential element for the drafting of technical standards is the analysis of the cost and benefits that the proposed measures might entail. In order to help ESMA to base this cost-benefit analysis on objective figures, respondents to this discussion paper are kindly invited to accompany their responses with quantitative evidence. It is also particularly important to understand, for each of the possible envisaged requirements, how long it would be necessary for the industry to implement the necessary arrangements to comply with them. Respondent are therefore invited to provide explanations for each of their responses and to accompany those with information on cost and benefits and timing for implementation. Information provided in this respect, as well as any response to this discussion paper will be treated in a confidential manner where requested.
5. As part of the analysis carried out before issuing this discussion paper, ESMA has consulted the Post-trading Consultative Working Group. The input provided by these industry experts was duly considered in the development of the draft technical standards.

### III. Discussion Paper

#### III.I OTC Derivatives

6. In developing the draft technical standards on OTC Derivatives, ESMA has considered reports prepared by international bodies including the Recommendations of the FSB report on Implementing OTC Derivatives Market Reforms, the draft requirements for Mandatory Clearing of IOSCO, and the Supervisory Guidance for assessing bank's financial instrument fair value practices of the Basel Committee on Banking Supervision.
7. These reports have provided a solid basis to ESMA although not always being specific enough for the level of granularity required for the draft technical standards. ESMA has therefore conducted further analysis and work to develop draft technical standards consistent with the international high level principles. ESMA aimed at ensuring the global compatibility of the EU requirements, thus permitting EU market participants active on OTC derivative markets to operate on a global basis.

#### **Clearing Obligation (Article 3)**

##### Contracts having a direct, substantial and foreseeable effect within the EU

8. Pursuant to EMIR, counterparties to OTC derivatives that have been concluded between third country entities that would be subject to the clearing obligation if they were established in the EU, shall clear those OTC derivative contracts that have a direct, substantial and foreseeable effect within the EU, or where such obligation is necessary or appropriate to prevent the evasion of any provision of EMIR.
9. The development of this draft technical standard has been added at a late stage in EMIR negotiations and therefore ESMA has recently started the analysis in this respect. Stakeholders' views would however be valuable in this context.

**Q1: In your views, how should ESMA specify contracts that are considered to have a direct, substantial and foreseeable effect within the EU?**

**Q2: In your views, how should ESMA specify cases where it is necessary or appropriate to prevent the evasion of any provision of EMIR for contracts entered into between counterparties located in a third country?**

##### Types of indirect clearing arrangements

10. In order to comply with the clearing obligation, a counterparty shall become a clearing member, a client or establish indirect clearing arrangements with a clearing member. These arrangements shall not increase counterparty risk and shall ensure that the assets and positions of the counterparty benefit from the protection granted by segregation, portability and default procedure. ESMA is required to specify the types of indirect contractual arrangements that meet these conditions.
11. The reference to this technical standard has been added at a late stage in EMIR negotiations and therefore ESMA has only recently started the analysis in this respect. Stakeholders' views would however be valuable in this context.

**Q3: In your views, what should be the characteristics of these indirect contractual arrangements?**

**Clearing obligation procedure (Article 4)**

12. ESMA will analyse classes of OTC derivatives in order to assess the application of the clearing obligation. In order for ESMA to identify the relevant class of OTC derivatives, EMIR provides for a bottom up approach where when a competent authority authorises a CCP to clear a class of OTC derivatives, it will notify ESMA. For the determination of the classes of derivatives, ESMA will, in a first stage, use as a basis the classes of derivatives defined by the CCP and the competent authorities. In a second stage, ESMA may adopt a more granular approach within these classes of derivatives.

Notification from the competent authority to ESMA

13. A competent authority shall notify ESMA when it authorises a CCP to clear a class of OTC derivatives.
14. The CCP having requested authorisation to clear the class of derivatives to which the notification refers to should provide the information set out below to the competent authority, which will include such information in its notification to ESMA. The competent authority may complement this information as it considers appropriate including with its decision and analysis. ESMA acknowledges that all this information may not always be available, especially for new products.
15. For the purpose of assessing whether a class of OTC derivatives should be subject to the clearing obligation, ESMA considers at this time that the notification should include at least:
  - a. A clear identification of the OTC derivative contracts and of the relevant class of OTC derivatives they belong to i.e. the characteristics and the range of derivative contracts within the class of derivative contracts, as well as all the elements to be included in the ESMA register and any further characteristics necessary to distinguish the OTC derivative contracts within the relevant class from derivative contracts outside of the relevant class of assets;
  - b. Evidence of the degree of standardisation of the relevant class of OTC derivatives' contractual terms and operational processes;
  - c. Data on the volume of the relevant class of OTC derivatives;
  - d. Data on the liquidity of the relevant class of OTC derivatives; and
  - e. Evidence of availability to market participants of fair, reliable, and generally accepted pricing information in the relevant class of OTC derivatives and any available evidence of the impact of the clearing obligation on availability to market participants of pricing information.
16. For the purpose of assessing the date or dates from which the clearing obligation takes effect, including any phasing-in and the categories of counterparties to which the clearing obligation applies, ESMA considers at this time that the notification should include at least:
  - a. Data on the expected volume of the relevant class of derivatives following the application of the clearing obligation;
  - b. Information on whether other CCPs already clear the same class of OTC derivatives;
  - c. Evidence of the ability of the CCP to handle the expected volume as a result of the clearing obligation and to manage the risk arising from the clearing of the relevant class of OTC derivatives;

- d. Information on the type and number of counterparties active and expected to be active within the market for the relevant class of OTC derivatives;
  - e. An outline of the different tasks to be completed in order to start clearing with the CCP, together with the determination of the time required to fulfil each task; and
  - f. Information on the risk management, legal and operational capacity of the range of counterparties active in the market for the relevant class of derivative contracts that would be subject to the clearing obligation.
17. For the class of OTC derivatives and for each derivative contract within such class, ESMA considers that the notification by the competent authority should at least include the following relevant market information:
- a. Number of transactions;
  - b. Total volume and trend;
  - c. Total open interest and trend;
  - d. Depth of orders including the average number of orders and of requests for quotes;
  - e. Tightness of spread;
  - f. Measures of liquidity under stressed market conditions; and
  - g. Measures of liquidity for the execution of default procedures.
18. In order to prove the existence of fair reliable and generally accepted pricing information in the relevant class of OTC derivatives, the CCP should provide to the competent authority, for the class of derivatives and for each derivative contract within such class, at least data on daily reference price as well as the number of days per year with reliable reference price.
19. The evidence and information provided by the competent authority above should be analysed by ESMA which would also give due consideration to :
- a. The evidence provided in the course of the public consultation;
  - b. Where available, information gathered from trade repositories and execution venues;
  - c. Where appropriate, information gathered from any other sources, including information gathered from the consultation with third country competent authorities.
- Q4: What are your views on the required information? Do you have specific recommendations of specific information useful for any of the criteria? Would you recommend considering other information?**
- Q5: For a reasonable assessment by ESMA on the basis of the information provided in the notification, what period of time should historical data cover?**
20. ESMA considers that where, following a negative assessment of the eligibility for the clearing obligation of a given class of derivative contracts, the competent authority is informed that market conditions or any of the information provided above change, such competent authority should have the ability to submit a new notification with updated information to ESMA. The CCPs will likely inform the competent authorities of such changes. As a result, ESMA should perform a new assessment on the eligibility of that class of OTC derivative for the clearing obligation on the basis of the updated information notified to it.

**Q6: What are your views on the review process following a negative assessment?**

Criteria to be assessed by ESMA under the clearing obligation procedure

21. In developing the draft technical standards related to the class of derivatives that should be subject to the clearing obligation, ESMA shall take into consideration criteria defined in EMIR, i.e. the degree of standardisation of the relevant class of OTC derivatives' contractual terms and operational processes, the volume and the liquidity of the relevant contracts within the relevant class of derivatives and the availability of pricing information.

22. In assessing these criteria ESMA should consider:

- a. That the contractual terms standardisation refers to the use of common legal documentation, including master netting agreements, definitions and confirmations which set forth contract specifications commonly used by counterparties and operational processes standardisation refers to the extent to which product trade processing and lifecycle events are managed in a common manner to a widely agreed-upon timetable;
- b. Whether the margins would be proportionate to the risk that the clearing obligation intends to mitigate and the historical stability of the liquidity through time, the likelihood that liquidity would remain sufficient in case of default of a clearing member;
- c. Whether the relevant information to correctly price the contracts within the relevant class of derivatives is easily accessible to counterparties on a reasonable commercial basis including once the obligation to clear is in force.

**Q7: What are your views regarding the specifications for assessing standardisation, volume and liquidity, and availability of pricing information?**

Public register available on ESMA website

23. ESMA shall make available on its website a public register to identify the classes of OTC derivatives subject to the clearing obligation.

24. ESMA considers that for the identification of the class of derivatives subject to the clearing obligation, the public register referred to in EMIR should include:

- a. The general class of derivative contracts;
- b. The type of derivative contracts;
- c. The underlying, with the indication on whether it is on a single financial instrument or issuer or on an index or portfolio;
- d. The currency;
- e. The range of maturities;
- f. The settlement conditions;
- g. The range of payment frequency;
- h. The calculation and business day convention
- i. Any other characteristic required to identify one contract in the relevant class of derivatives from another.

25. For the identification of the CCPs authorised or recognised to clear the classes of derivatives subject to the clearing obligation, ESMA contemplates that the public register referred to in EMIR would include:

- a. The Identification Code, possibly a Legal Entity Identifier (LEI) or if not available a BIC code;
- b. The full name;
- c. The country of establishment;
- d. The competent authority designated in accordance with Article 18 of EMIR

26. ESMA also considers that the public register should also include:

- a. The date from which the clearing obligation takes effect
- b. Any possible phasing-in by categories of counterparties;
- c. The reference of the Commission Regulation adopting draft implementing technical standards, according to which the clearing obligation was established;
- d. Any additional condition.

**Q8: What are your views, regarding the details to be included in ESMA register of classes of derivatives subject to the clearing obligation?**

**Q9: Do you consider that the data above sufficiently identify a class of derivatives subject to the clearing obligation and the CCPs authorised or recognised to clear the classes of derivatives subject to the clearing obligation?**

#### **Non-financial counterparties (Article 5/7)**

27. EMIR recognises that non-financials use OTC derivative to protect themselves against commercial risks directly linked to their commercial activities. As a result, these OTC derivative contracts that protect the non-financial against risks directly related to their commercial activities and treasury financing activities as well as those that do not protect against such risk but do not exceed a clearing threshold are not subject to the clearing obligation. At the point where the clearing threshold would be exceeded, the clearing obligation would apply to all OTC derivative contracts the non-financial counterparty will enter into after the time that the firm has exceeded the threshold.

28. In order to calculate whether it exceeds the clearing threshold, a non-financial counterparty shall not include in its calculation the OTC derivative contracts which are objectively measurable as reducing risks directly related to its commercial activity or treasury financing activity or that of its group.

#### Criteria for establishing which derivative contracts are objectively measurable as reducing risk directly related to the commercial activity or treasury financing

29. By reference to European accounting rules, ESMA considers that an OTC derivative entered into by a non-financial counterparty is deemed to be objectively measurable as reducing risks directly related to the commercial activity or treasury financing activity of that non-financial counterparty or of that group, when, whether individually or in combination with other derivative contracts, its objective is to reduce the following risks:

- a. The potential change in the value of assets, service, inputs, products, commodities, liabilities that the non-financial counterparty or its group owns, produces, manufactures, processes, provides, purchases, merchandises leases, sells or incurs or reasonably anticipates owning, producing, manufacturing, processing, providing, purchasing, merchandising, leasing, selling or incurring in the ordinary course of its business; or
  - b. The potential change in the value of assets, service, inputs, products, commodities, liabilities referred to in letter a, resulting from fluctuation of interest rates, inflation rates or foreign exchange rates.
30. ESMA also considers that an OTC derivative entered into by a non-financial counterparty is deemed to be objectively measurable as reducing risks directly related to the commercial activity or treasury financing activity of that non-financial counterparty or of that group, when, the accounting treatment of the derivative contract is that of a hedging contract pursuant to IFRS principles as referred to in IAS 39 paragraph 71-102 on hedge accounting as endorsed by the European Commission.
31. Nevertheless, ESMA considers that an OTC derivative which is used for a purpose in the nature of speculation, investing, or trading should not be an OTC derivative objectively measurable as reducing risks directly related to the commercial activity or treasury financing activity of a non-financial counterparty or of a group as provided above.

**Q10: In your view, does the above definition appropriately capture the derivative contracts that are objectively measurable as reducing risk directly related to the commercial or treasury financing activity?**

#### Clearing Threshold

32. For the purpose of setting the clearing threshold, ESMA considers referring to the notional value of OTC derivatives subject to the clearing obligation.
33. As there is a broad definition of the OTC derivatives that do not enter into the calculation of the clearing threshold because they relate to the non-financials' activity directly reducing commercial risks or treasury financing activity, ESMA considers that the clearing threshold should be set at a low level. It should also be simple to implement by non-financials.
34. The clearing threshold could be set across asset classes or per asset class. Nevertheless, referring to a clearing threshold per asset class and per legal entity and group would be difficult to implement. ESMA therefore suggests using a threshold across all asset classes.
35. One may consider that if the threshold is set at the level of the legal entity, a mechanism preventing circumvention of the clearing obligation may be required so that groups cannot multiply the number of their legal entities to use the threshold several times. The mechanism could articulate a double clearing threshold set at the level of the legal entity and of the group. Indeed, application of a total global clearing threshold for all legal entities or groups combined would lead to a situation where the first entities to enter into OTC derivative transactions could consume the full threshold to the detriment of other participants.
36. In order to set up the exact value of the clearing threshold, more data should be gathered, including net positions and exposures related to the OTC derivative contracts that are not centrally cleared by counterparties.

**Q11: In your views, do the above considerations allow an appropriate setting of the clearing threshold or should other criteria be considered? In particular, do you agree that the broad definition of the activity directly reducing commercial risks or treasury financing activity balances a clearing threshold set at a low level?**

**Risk mitigation for non-CCP cleared contracts (Article 6/8)**

37. Financial and non-financial counterparties that enter into an OTC derivative which is not subject to the clearing obligation shall mitigate risks by using different techniques. The risk mitigation techniques shall be further specified through technical standards to be developed for a part by ESMA and for another part jointly by ESMA, EBA and EIOPA. This discussion paper relates to the risk mitigation to be specified through ESMA technical standards. Some other risk management techniques are specified in the ESAs joint discussion paper dedicated to joint technical standards.

Timely confirmation

38. ESMA considers financial counterparties and non-financial counterparties exceeding the clearing threshold should confirm, where available via electronic means, the terms of any OTC derivative they have entered into with each other and which is not cleared by a CCP:

- a. within 15 minutes from the execution of the derivative contract, when the transaction is electronically executed;
- b. within 30 minutes from the execution of the derivative contract when the transaction is not electronically executed but is electronically processed;
- c. on the same calendar day for transactions that are not executed or processed electronically.

39. ESMA also considers that parties to transactions executed with counterparties other than those indicated above should confirm, where available via electronic means, the terms of any OTC derivative they have entered into and which is not cleared by a CCP:

- a. no later than the business day following the execution of the OTC derivative when the transaction is electronically executed or processed;
- b. no later than the [x] business days following the execution of the OTC derivative when the transaction is not executed or processed electronically.

40. Financial counterparties should also report to the competent authority designated in accordance with Article 48 of Directive 2004/39/EC the number of unconfirmed OTC derivative transactions that have been outstanding for more than [x] days.

41. ESMA recognises that proposals above would entail a modification of the current practice related to execution of transactions on the OTC derivative markets as the legal terms of the contracts are generally agreed after the execution, but considers they would contribute to a low level of log of unconfirmed trades and thus a reduction of risk of potential legal disputes.

**Q12: What are your views regarding the timing for the confirmation and the differentiating criteria? Is a transaction that is electronically executed, electronically processed or electronically confirmed generally able to be confirmed more quickly than one that is not?**

**Q13: What period of time should we consider for reporting unconfirmed OTC derivatives to the competent authorities?**

Marking-to-market and marking-to-model

42. ESMA is required to develop draft technical standards specifying the market conditions preventing marking-to-market and the criteria for using marking-to-model.

43. ESMA is of the view that the choice between marking-to-market or marking-to-model of contracts that have been assessed as insufficiently standardised for central clearing seems to heavily push towards the second option. Indeed, the fact that standardisation of the class of OTC derivative is deemed insufficient shows that there is a limited number of other similar products in the OTC market and therefore marking-to-market may be difficult to achieve.

44. ESMA considers, by reference to European accounting rules, that market conditions would prevent marking-to-market of an OTC derivative, when:

- a. the market is inactive, or
- b. the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed.

A market would be deemed inactive when quoted prices are not readily and regularly available and those prices do not represent actual and regularly occurring market transactions on an arm's length basis.

45. Where market conditions prevent marking-to-market, financials and non-financials exceeding the clearing threshold shall use reliable and prudent marking-to-model. ESMA considers that the marking-to-model valuation technique should:

- a. incorporate all factors that counterparties would consider in setting a price,
- b. be consistent with accepted economic methodologies for pricing financial instruments,
- c. be calibrated and tested for validity using prices from any observable current market transactions in the same financial instrument or based on any available observable market data,
- d. be validated and monitored by a unit independent from the risk taking unit, and
- e. be duly documented and approved by the board as frequently as necessary and at least annually.

**Q14: In your views, is the definition of market conditions preventing marking-to market complete? How should European accounting rules be used for this purpose?**

**Q15: Do you think additional criteria for marking-to-model should be added?**

Reconciliation of non-cleared OTC derivative contracts

46. ESMA considers that financial and non-financial counterparties should agree in writing or in other equivalent electronic means with each of their counterparties on the terms of their portfolio reconciliation.

47. Also ESMA considers that portfolio reconciliation should be performed by the counterparties to the OTC derivatives with each other, or by a qualified third party duly mandated to this effect by a counterparty. The portfolio reconciliation should cover key trade terms that identify a particular derivative transaction.

48. Furthermore, ESMA's view is that, for the early identification of any discrepancy in the material term of a contract or in its valuation, the portfolio reconciliation should be performed at least:

- a. each business day when the counterparties have 300 or more OTC derivatives with each other; or
- b. at an appropriate time period based on the size and volatility of the OTC derivative portfolio of the counterparties with each other and at least once per quarter for portfolio of less than x derivative contract with a counterparty and at least once per week for portfolio between x and 300 derivative contracts with a counterparty for any other OTC derivative transaction not captured under (a) above.

49. Finally, and without prejudice to provisions related to dispute resolution, ESMA considers that all counterparties should also have in place the necessary arrangements to timely resolve any discrepancy in a material term of a contract or in its valuation identified as part of the portfolio reconciliation.

**Q16: What are your views regarding the frequency of the reconciliation? What should be the size of the portfolio for each reconciliation frequency?**

#### Portfolio compression

50. ESMA considers that portfolio compression is a risk-reducing exercise which should be run on a regular basis.

51. Where multilateral portfolio compression services are proposed for a class of OTC derivatives, counterparties, especially when they already use services of that service provider, should include in the portfolio compression cycle all the OTC derivatives in their portfolio that are eligible for such cycle.

52. ESMA contemplates that financial counterparties and non-financial counterparties with at least 500 or more non centrally cleared derivative transactions should conduct at least twice a year a portfolio compression exercise for their full portfolio, or provide a reasonable and valid explanation to the relevant competent authority for not conducting such an exercise.

53. Financial and non-financial counterparties should terminate each of the fully offset derivative contract no later than the day following the execution of the fully offsetting derivative contract

**Q17: What are your views regarding the threshold to mandate portfolio compression and the frequency for performing portfolio compression?**

#### Dispute resolution

54. ESMA contemplates that in order to identify and resolve any dispute, financial counterparties and non-financial counterparties when concluding an OTC derivative with each other should have:

- a. Detailed procedures and process in place for identifying, recording, and monitoring disputes relating to the recognition, valuation of the contract or to the exchange of collateral between the two counterparties. Those procedures should at least record the length of time for which the dispute remains outstanding, the counterparty, and the amount which is disputed;
- b. Detailed procedures and process in place for resolving disputes in a timely manner;

- c. Procedures agreed by the counterparties to deal with disputes that are not resolved within 5 business days. This should include, but not be limited to, a combination of legal settlement, third party arbitration and/or a market polling mechanism.

55. ESMA also contemplates that financial counterparties should report to the competent authority designated in accordance with Article 48 of MiFID any disputes between counterparties relating to an OTC derivative, its valuation or the exchange of collateral for an amount or a value higher than EUR 15m and where the dispute is outstanding for at least 15 business days.

**Q18: What are your views regarding the procedure counterparties shall have in place for resolving disputes?**

**Q19: Do you consider that legal settlement, third party arbitration and/or a market polling mechanism are sufficient to manage disputes?**

**Q20: What are your views regarding the thresholds to report a dispute to the competent authority?**

#### Intra-group exemptions

56. For the application of the intragroup exemption to the exchange of collateral, two sets of draft technical standards are required:

- a. in relation to criteria to be used and in particular practical and legal impediments to the prompt transfer of own funds or repayment of liabilities between counterparties;
- b. in relation to the details of the intragroup OTC derivatives to be included in the notifications to the competent authority, the details of the information to be publicly disclosed by counterparty of exempted intragroup transaction on the exemption.

57. Draft technical standards under letter a. are expected to be developed jointly by EBA, EIOPA and ESMA and related considerations will be included in the joint discussion paper.

58. Draft technical standards under letter b. are under ESMA sole responsibility. These draft RTS have been added at a late stage in EMIR negotiations and therefore ESMA has only recently started the analysis in this respect. Stakeholders' views would however be valuable in this context.

**Q21: In your views, what are the details of the intragroup transactions that should be included in the notifications to the competent authority?**

**Q22: In your views what details of the intragroup transactions should be included in the information to be publicly disclosed by counterparty of exempted intragroup transactions?**

### **III.II CCP Requirements**

59. In developing the draft technical standards on CCP Requirements, ESMA has placed emphasis on the CPSS-IOSCO draft Principles for Financial Market Infrastructure, which serve as a global benchmark for CCPs. Additionally relevant parts of the global regulatory standard on bank capital adequacy and liquidity as agreed by the members of the Basel Committee on Banking Supervision have been considered in defining those regulatory technical standards which address the risk management of a CCP.
60. However, in many cases, these global standards are not specific enough for the level of granularity that draft technical standards are expected to take. In such circumstances, ESMA will need to introduce more detailed requirements that will still be compatible with the high level principles agreed at international level, thus ensuring the global compatibility of the EU requirements and permitting EU CCPs to operate on a global basis.
61. In addition, while drafting the RTS and ITS on CCP requirements; ESMA is duly consulting the members of the ESCB who have been actively involved in the development of these standards.
62. In line with recital 38 of EMIR, CPSS-IOSCO draft principles and CGFS recommendations, it should also be noted that in developing draft technical standards on CCP requirements and in particular on margins and collateral, due regard has been given to the procyclical<sup>1</sup> effects that these requirements (including haircuts on collateral) could play. This issue also raises particular macro-prudential concerns and needs to be duly addressed in the definition of the standards, to avoid continuous adjustments in a crisis situation that can further aggravate the crisis.

#### **Access to a venue of execution (Article 8a)**

63. According to Article 8a of EMIR, access to a CCP by a venue of execution can only be granted if such access would not require interoperability or threaten the smooth and orderly functioning of markets in particular due to liquidity fragmentation.
64. In this context, ESMA is required to specify through draft RTS the notion of liquidity fragmentation. This RTS has been added at a later stage of the negotiation of level 1 text and ESMA has only recently started analysing the issue. Therefore, any initial feed-back from stakeholders on this matter would be appreciated.

#### **Q23: What are your views on the notion of liquidity fragmentation?**

#### **Recognition of a CCP (Article 23)**

65. Under Article 23 of EMIR, ESMA is required to draft regulatory technical standards specifying the information that the applicant CCP need to provide to ESMA in its application for recognition. Also in this case the proposal for a draft RTS was included at a later stage of the EMIR negotiation and ESMA is currently analysing the current practices in the EU and in third countries for recognising third country counterparties.

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<sup>1</sup> Procyclicality refers to changes in risk management practices that are positively correlated with business or credit cycle fluctuations and that may cause or exacerbate financial instability.

## **Organisational Requirements (Article 24)**

66. Under Article 24 of EMIR, ESMA is required to draft regulatory technical standards specifying details on:

- a. governance arrangements;
- b. compliance policy and procedures;
- c. information technology systems;
- d. reporting lines;
- e. remuneration policy;
- f. disclosure of rules and governance arrangements and admission criteria;
- g. audits.

In Article 24 reference is also made to business continuity. However, ESMA considers that given that a specific requirement and technical standard is already envisaged under Article 32, it would be better treated consistently under such article.

67. ESMA preliminary thinking is that CCP requirements on governance arrangements should include the following:

- a. They should be designed in such a way as to promote the sound and prudent management and thereby support financial stability and foster fair and efficient markets.
- b. The CCP organisational structure should be well-documented and include the policies, procedures and processes by which the board and senior management operate. In particular, the following should be specified:
  - the composition, role and responsibilities of the board, any board committees and of the senior management;
  - the reporting lines between the senior management and the board;
  - the procedures for the appointment of board members and senior management;
  - the design of the risk management, compliance and internal control functions; and
  - the processes for ensuring accountability;
  - procedures for stakeholders' involvement;

68. ESMA also considers that although the board of a CCP always assumes the final responsibility and accountability for the CCP's actions and for the compliance with the relevant regulations, a CCP should name dedicated chief risk officer, chief technology officer and chief compliance officer and heads of any other function it considers relevant. It should be clarified that depending on the structure and complexity of the CCP, single individuals could perform more than one of these functions. However, it is important from a regulatory and supervisory perspective to clearly identify the relevant contact point within the CCP that is responsible for these essential functions.

69. Where a CCP is part of a larger organisation it should duly consider any implications of the larger organisation for its own governance arrangements including whether it has the necessary level of independence to meet its regulatory commitments as a distinct legal entity and that this independence will not be compromised by the group structure or by board members also being members of the board of other parts of the same group. In particular, such CCP should consider specific procedures for preventing and managing conflicts of interest including with respect to outsourcing arrangements.

**Q24: What are your views on the possible requirements that CCP governance arrangements should specify? In particular, what is your view on the need to clearly name a chief risk officer, a chief technology officer and a chief compliance officer?**

**Q25: Are potential conflicts of interests inherent to the organisation of CCPs appropriately addressed?**

70. ESMA considers that in designing its risk management framework a CCP should document policies, procedures and systems that identify, measure, monitor and manage all the risks it is exposed to, such as: credit, market, liquidity, operational (including legal) and business risks. As part of its integrated and comprehensive view of all these risks, the CCP should consider the risks it bears from and poses to its clearing members and, to the extent practicable, clients as well as the risks it bears from and poses to other entities, such as interoperable CCPs, securities settlement and payment systems, settlement banks, liquidity providers, central securities depository, other critical service providers and venues of execution served by the CCP. CCPs should, therefore, develop appropriate risk management tools to be in a position to address and report on all material risks, including the identification and management of system, market or other interdependencies.

71. CCPs should also ensure that the risk management function has the necessary authority, resources, expertise and access to all relevant information and ensure that it is sufficiently independent from the business areas and has a direct reporting line to the board. The adequacy and effectiveness of the CCP's risk management policies, procedures and systems should be subject to independent audits.

72. CCPs should, therefore, establish and maintain an internal audit function which is separate and independent from the other functions and activities of the CCP, and has direct access to the board and has necessary authority, resources, expertise, and access to all relevant documents. It should at least fulfil the following tasks:

- a. establish, implement and maintain an audit plan to examine and evaluate the adequacy and effectiveness of the CCP's systems, risk management processes, outsourced activities, internal control mechanisms and arrangements;
- b. issue recommendations on the basis of such assessment;
- c. verify the compliance with those recommendations;
- d. report internal audit matters to the board.

**Q26: Do the reporting lines – as required – appropriately complement the organisation of the CCP so as to promote its sound and prudent management?**

73. With respect to CCPs' remuneration policy, ESMA considers that it should be designed in such a way as to promote the soundness and effectiveness of its risk management. The policy should reduce incentives towards excessive risk taking and prevent a relaxation of risk standards that may arise from inappropriate remuneration schemes. The responsibility for the appropriate design of the

remuneration policy lies with the board. In doing so, it should establish a remuneration committee to design and further develop the policy and monitor its implementation. Staff engaged in risk management, compliance and internal audit should be compensated in a manner that is independent of the business performance of the CCP. The level of remuneration should be adequate in terms of responsibility as well as in comparison to the level of remuneration in the business areas. Finally, the remuneration policy should be subject to independent audit on an annual basis.

**Q27: Do the criteria to be applied in the CCP remuneration policy promote sound and prudent risk management? Which additional criteria should be applied, in particular for risk managers, senior management and board members?**

74. With reference to CCPs' information technology systems, ESMA considers that:

- a. CCPs should ensure that its information technology systems including hardware and software components are designed and operated in a way that they are reliable and secure as well as capable of processing the information necessary for the CCP to perform its activities and operations in a safe and efficient manner. The information technology architecture should be well-documented and based on internationally recognised standards and industry best practices.
- b. The systems should be adequate to deal with the CCP's operational needs and the risks the CCP faces, be resilient (including in stressed market conditions) and be scalable to process additional information, if necessary.
- c. The CCP should subject its systems to stringent testing, simulating stressed conditions, before first-time use, after making significant changes and after a major disruption has occurred. Clearing members and clients, interoperable CCPs and other interested parties will be involved as appropriate in the design and conduct of these tests.
- d. A CCP should maintain a robust information security framework that appropriately manages its information security risk. The framework should include appropriate mechanisms, policies and procedures to protect information from unauthorised disclosure, ensure data accuracy and integrity and guarantee the availability of the CCP's services. The information security framework should include, at a minimum, the following mechanisms: i) access controls to the system; ii) adequate safeguards against intrusions and data misuse; iii) specific devices to preserve data authenticity and integrity, including, but not limiting to cryptographic techniques; iv) reliable networks and procedures for accurate and prompt data transmission without major disruptions; and v) audit trails.
- e. When outsourcing its information technology system or parts of it to another entity or to a third party service provider, the CCP should ensure that this entity or service provider meets the same standards the CCP would need to meet when using in-house systems. The CCP should have adequate and documented arrangements for the selection of such entities or service providers, timely access to all information and proper control and monitoring tools.
- f. The information technology systems and the information security framework should be reviewed, at a minimum, on an annual basis. They should be subject to independent audit assessments and the results of these assessments should be reported to the board and should be made available to the competent authority.

75. ESMA also considers that:

- a. CCPs' accounts should be maintained also in conformity with international standards and financial statements should be prepared at least on an annual basis and be audited in accordance with the relevant EU legislation on auditing and made publicly available.
- b. The rules, procedures and contractual arrangements of the CCP should be adopted in written form or equivalent electronic means. The explanatory material should be accurate, up-to-date and readily available to the competent authority, clearing members and, where known to the CCP, clients. The CCP should have a process for proposing and implementing changes to its rules and procedures and consult with clearing members and, where relevant, seek approval by competent authority on the changes.
- c. In developing its rules, procedures and contractual arrangements, CCPs should consider relevant regulatory principles and industry standards and market protocols and clearly indicate where such practices have been incorporated into the documentation governing the rights and obligations of the CCP, its clearing members and other relevant third parties. In particular, CCPs should clearly indicate the extent to which they rely on determinations by third parties.
- d. CCPs should identify and analyse, as appropriate through independent legal opinions, potential conflict of laws issues and develop rules and procedures to mitigate legal risk resulting from such issues. CCPs' rules and procedures should clearly indicate the law that is intended to apply to each aspect of the CCP's activities and operations.
- e. CCPs should establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the CCP and its employees to comply with the relevant legal and regulatory requirements.
- f. CCPs should publicly disclose all relevant information necessary to understand whether and how it meets its legal obligations ensuring its sound and prudent operation. The CCP should publicly disclose at a minimum: i) their governance arrangements, including their organisational structure as well as key objectives and strategies; ii) their rules and procedures, including default procedures; iii) relevant business continuity information; iv) key elements of the remuneration policy; v) key financial information such as, but not limited to, the latest audited financial statements; vi) the list of all clearing members; vii) any material changes in their governance arrangements, objectives, strategies and key policies. Where a CCP considers that the disclosure of certain elements would put it a competitive disadvantage, it should inform the competent authority and not disclose such information.
- g. CCPs should disclose to clearing members and to clients (when known by the CCP) all relevant information on the design and operations of the CCP as well as on the rights and obligations of clearing members, in order to enable them to identify clearly and understand fully the risks and costs associated with using the CCP's services. In order to facilitate understanding of its procedures and arrangements the CCP should offer additional documentation and training, where appropriate. The information to be disclosed to clearing members should include, at a minimum, the following:
  - the CCP's current and prospective clearing offering, including detailed information on services with a clear description of the actual content of each service and of the costs incurred when using the service;

- the CCP’s risk management systems, techniques and performance, including information on financial resources, price sources and models used in margin calculations;
  - the law and the rules governing (i) the access to the CCP, (ii) the contracts concluded by the CCP with clearing members and, where practicable, clients, (iii) the contracts that the CCP accepts for clearing, (iv) any interoperability arrangements, (v) the use of collateral and default fund contributions, including the liquidation of positions and collateral and the extent to which collateral is protected against third party claims (level of segregation).
- h. Information to be disclosed by the CCP should be accessible on its website. Information should be available in a language commonly used in the financial sector as well as in at least one of the official languages of the Member State where the CCP is established.

**Q28: What are your views on the possible organisational requirements described above? What are the potential costs involved for implementing such requirements?**

**Q29: Should a principle of full disclosure to the public of all information necessary to be able to understand whether and how the CCP meets its legal obligations be included in the RTS? If yes, which should be the exceptions of such disclosure requirements? Has the information CCP should disclose to clearing members been appropriately identified? Should clients, when known by the CCP, receive the same level of information?**

### **Record keeping (Article 27)**

76. Under Article 27 of EMIR, ESMA is required to draft regulatory technical standards specifying the details of the records and information to be retained by CCPs and implementing technical standards specifying the format of these records and information.

77. Record keeping is an essential element for assessing CCP compliance with the relevant regulations and a useful tool to monitor clearing members and, where relevant, clients activities and behaviours. ESMA is considering that CCPs should maintain transaction, position and business records. The first two will help monitor that the CCP correctly manages its exposures and enable the adequate reconstruction of the clearing process. They will also help identifying whether clearing members are behaving correctly. The business records will help demonstrating CCP compliance and will help in facilitating the resolution of potential disputes with clearing members.

78. With reference to transaction records, ESMA considers that:

- a. CCPs should maintain records of all contracts cleared and should ensure that their records include all information necessary to conduct a comprehensive and accurate reconstruction of the clearing process for each contract and that each contract record is univocally identifiable and searchable by every field indicated in letter b. below.
- b. In relation to every contract received for clearing, a CCP should immediately make a record at a minimum of the following details:
  - the unit price (and price notation), the quantity (and quantity notation);

- the clearing capacity, which identifies whether the contract was a buy or sell from the perspective of the CCP recording;
- the instrument identification
- the identification of the clearing member and of the client, if known to the CCP, and in case of a give-up, the identification of the party that transferred the contract;
- the identification of the venue where the contract was concluded (if OTC such indication will apply);
- the date and time of interposition of the CCP in the contract;
- the date and time of termination of the contract;
- the terms and modality of settlement;
- the date and time of settlement or of buy-in of the contract;

and to the extent they are applicable of the following details:

- the day and the time at which the contract was originally concluded;
- the identification of the original terms and parties of any contract cleared;
- the identification of the interoperable CCP clearing one leg of the transaction.

79. With reference to positions, ESMA considers that CCPs should keep the following records:

- a. They should maintain records of positions held by each clearing member separately for each account kept in accordance with Article 37 of EMIR and should ensure that these records include all information necessary to conduct a comprehensive and accurate reconstruction of the transactions that established the position and that each record is identifiable and searchable at a minimum by each of the field specified in letter b. below.
- b. CCPs, at the end of every day and in relation to each position, should make a record, at a minimum of the following details, to the extent they are applicable to the position in question:
  - the identification of the clearing member, of the client, if known to the CCP, and of the interoperable CCP maintaining such position, where applicable;
  - the position identification as “long” or “short”;
  - the daily calculation of the value of the position with records of the prices at which the contracts are valued, and of any other relevant information;
  - the amounts of margins, default fund contributions and other financial resources, distinguished by pre-funded and non-pre-funded, called by the CCP at the end of day and intra-day, with respect to each single clearing member and client account.

80. As for business records, ESMA considers that CCPs should maintain adequate and orderly records of activities related to its business and internal organisation. Those records should be made each time a material change in the relevant documents occurs. In particular CCPs should keep the following:

- a. the organisational charts for the board and relevant committees, clearing unit, risk management unit, and all other relevant units or divisions;
- b. the identities of the shareholders or members, whether direct or indirect, natural or legal persons, that have qualifying holdings and the amounts of those holdings;

- c. the documents attesting the policies, procedures and processes required under the relevant organisational requirements;
- d. the minutes of board meetings and, if applicable, of meetings of sub-committees of the board and of senior management committees;
- e. the minutes of meetings of the risk committee;
- f. the minutes of consultation groups with clearing members and clients, if any
- g. internal and external audit, risk management, compliance, and consultant reports (including management responses);
- h. the business continuity policy and disaster recovery plan;
- i. the liquidity plan and the daily liquidity reports (see section on liquidity risk controls);
- j. records reflecting all assets and liabilities and capital accounts as required by EMIR and implementing measures;
- k. complaints received, with information on the complainant's name, address, and account number; the date the complaint was received; the name of all persons identified in the complaint; a description of the nature of the complaint; the disposition of the complaint, and the date the complaint was resolved;
- l. records of any interruption of services or dysfunction, including a detailed report on the timing, effects and remedial actions;
- m. records of the results of the back and stress tests performed;
- n. written communications with competent authorities;
- o. legal opinions received in accordance with RTS on organisational requirements;
- p. where applicable, documentation on interoperability arrangements with other CCPs.

81. ESMA also considers that:

- a. The records should be retained in a medium that allows the storage of information in a format accessible for future reference by the competent authorities, and in such a form and manner that the following conditions are met: i) it is possible for the competent authorities to access the records readily and to reconstitute each key stage of the processing involved; ii) it is possible to record, trace and retrieve the original content of a record before any corrections or other amendments; and iii) it is not possible for the records to be manipulated or altered.
- b. All records required to be kept by CCPs should be open to inspection by the competent authority. The CCP should name the relevant person or persons that can, without delay, explain the content of the records maintained.

**Q30: What are your views on the possible records CCPs might be required to maintain?**

82. ESMA is aware of the fact that the costs for maintaining the records vary very much as a function of how the records are maintained, i.e. whether they should be maintained online (immediately available) or if they can be maintained offline (i.e. they can be retrieved within few days delay).

83. EMIR requires that all records are maintained for at least [10] years. However, EMIR does not specify the modality according to which they can be stored. ESMA could, therefore, consider to differentiate in the ITS the modality according to which these records should be maintained. This would be particularly relevant for transaction and position records.

84. ESMA considers that if the CCP maintains the relevant records outside of the Union, no legal or technical impediment should occur to the prompt access to this data. Competent authority should be able to access this data with the same modality and delay as if they were maintained within the Union.
85. Finally, ESMA might also consider requiring that for transaction and position records a direct data feed to the competent authority could be envisaged, when requested by the latter.

**Q31: What are your view on the modality for maintaining and making available the above records? How does the modality of maintaining and making available the records impact the costs of record keeping?**

### **Business continuity (Article 32)**

86. Under business continuity, ESMA is required to develop technical standards indicating the minimum content and requirements of the business continuity policy and disaster recovery plan and the requirements they should specify.
87. Given the systemic importance of CCPs, the continued and uninterrupted functioning of a CCP is of crucial importance for the stability of the financial markets. Having this in mind, ESMA considers that:
- a. CCPs should have a business continuity policy and a disaster recovery plan approved by the board and subject to independent reviews. The business continuity policy and the disaster recovery plan should contain the arrangements to maintain a minimum service level of critical functions. At a minimum, those arrangements should ensure that in extreme scenarios critical functions are completed on time (in line with the recovery time specified below) and agreed service levels are met.
  - b. The business continuity policy should:
    - identify all critical business functions and related systems, and include the CCP’s strategy, policy, and objectives towards the continuity of these functions and systems. In doing so, external links and interdependencies within the financial infrastructure (e.g. trading venues clearing via the CCP, securities settlement systems, payment systems, credit institutions used by the CCP or interoperable CCPs), as well as outsourced functions or services should be duly considered in the business continuity policy.
    - identify the maximum acceptable down time of critical functions and systems. Backup systems should commence processing immediately with a maximum recovery time for the CCP’s critical functions of 2 hours.
  - c. The disaster recovery plan should identify for critical functions the recovery point and recovery time objectives and determine the most suitable recovery strategy for each of these functions. In determining the recovery times for each function the CCP should take into account the overall impact on the market efficiency.
  - d. CCPs should conduct: i) a business impact analysis to identify the critical functions for which a minimum service level should be maintained; ii) a proper scenario based risk analysis of these critical functions. In particular they should assess the risk of dependencies to external providers (e.g. utilities) and manage these risks through appropriate contractual and organisational arrangements.

88. In order to maintain the continuity of their critical functions CCPs should:

- a. Have adequate human resources, systems and controls;
- b. Establish a secondary processing site with a geographically distinct risk profile from the primary site;
- c. Consider the establishment of a third processing site, in particular if the diversity of the risk profiles of the primary and secondary sites does not provide sufficient confidence that the CCP's business continuity objectives will be met in all scenarios.
- d. Maintain or have immediate access to a secondary business site, at least, to allow staff to ensure continuity of the service if the main location of business is not available.

89. To be up-to-date, ready to be used and effective, the business continuity policy and disaster recovery plans and the relevant arrangements should be tested at regular intervals. These tests should involve: i) scenarios of large scale disasters; ii) switchovers between primary and secondary sites; iii) the participation of clearing members, external providers and relevant institutions with which interdependencies have been identified in the business continuity policy.

90. CCPs should also regularly review and update their business continuity policies and disaster recovery plans to include all critical functions and define the most suitable recovery strategy for them. In particular, CCPs should review their business continuity policies and disaster recovery plans after every significant disruption, to identify the causes, and any required improvement to the normal operations or business continuity policies and disaster recovery plans.

91. Finally, every CCP should have a well-documented communication plan to ensure the adequate and up to date information and contact points the relevant stakeholders could rely on during a disruption.

**Q32: What are your views on the possible requirements for the business continuity and disaster recovery plan and in particular on the requirements for the secondary site? Would it be appropriate to mandate the establishment of a third processing site, at least when the conditions described above apply? What are the potential costs and time necessary for the establishment of a third processing site and for immediate access to a secondary business site?**

**Q33: Is the 2 hours maximum recovery time for critical functions a proportionate requirement? What are the potential costs associated with that requirement?**

### **Margins (Article 39)**

92. Under the RTS for margins, ESMA is required to define: a) the appropriate percentage above the minimum 99 per cent confidence interval that margins are required to cover for the different financial instruments; b) the liquidation period; c) the lookback period, i.e. the period over which the appropriate percentage should be covered, which is necessary to properly calibrate the model. In doing so ESMA shall take into account the objective to limit procyclicality and the conditions under which portfolio margining practices can be implemented.

93. In defining the appropriate percentage above 99 percent, ESMA is considering the pros and cons for an higher confidence level:

#### Pros

- Procyclicality. Setting margins in a conservative manner will help the CCP to maintain a sufficient buffer in stressed period, thus avoiding continuous adjustments via margins calls that can exacerbate a difficult market condition;
- Moral hazard. Setting higher confidence intervals would determine a lower use of default fund contribution, thus limiting the recourse to the latter and the moral hazard issue connected to it.
- Better capital treatment. Margins are expected to get a more favourable capital treatment than default fund contributions, thus clearing member would certainly have a preference for higher confidence intervals.
- Portability. If the overall risk that the CCP need to cover is manage via a larger recourse to margins, this would facilitate the portability of client positions. This is due to the fact that for a CCP will be easier to find a surviving clearing members if the positions that the latter should take are almost entirely covered by margins. The same will not be true if the surviving clearing member would be asked to pay a substantial contribution to the default fund in view of the client position it is taking.
- Short history. If the product the CCP intends to clear have short time series on which to calibrate its model, it would be justified to apply an higher confidence interval.

#### Cons

- Lower trading activity. Too high margins as a consequence of the higher confidence interval, might disincentivise trading on particular products, thus reducing the liquidity of those.
- Management of a default. If a CCP can rely mostly on margins, the management of a default would be seriously injured. With limited mutualised resources, the CCP could only rely on the resources of the defaulting clearing member, thus limiting the resources at its disposal in a default situation.
- Little justification for clearing member involvement in the CCP governance. In case of very limited mutualisation of losses, the clearing members have less reason for being directly involved in monitoring the CCP risk management, given that they risk only the money they post to cover their exposures.

94. Against this background, ESMA is considering two options for the definition of the appropriate confidence interval: a) defining a list of financial instruments whose characteristics are such to necessitate a specific percentage above 99 percent single tail interval coverage and applying a criteria based approach for the other financial instruments not explicitly considered; b) applying a criteria based approach for all financial instruments.

95. A criteria based approach for the determination of the adequate confidence interval could envisage that the CCP considers, at minimum, the following factors for each class of financial instruments that it clears:

- a. The complexities and level of pricing uncertainties associated with the relevant class of financial instruments, which may limit the validation of the initial and variation margin calculation.
- b. The risk characteristics of the class of financial instruments, which can include, but are not limited to, volatility, duration, liquidity, non-linear price characteristics, jump to default risk and wrong way risk.
- c. The degree to which other risk controls do not adequately limit credit exposures.
- d. The inherently leverage of the class of financial instruments, including whether the class of financial instruments are significantly volatile, highly concentrated among few clearing members or difficult to close out.
- e. Whether the positions held by the CCP are of a significant size.
- f. Whether the exposures generated by clearing members are significant compared to their underlying financial strength.

**Q34: Are the criteria outlined above appropriate to ensure that the adequate percentage above 99 per cent is applied in CCP's margin models? Should a criteria based approach be complemented by an approach based on fixed percentages? If so, which percentages should be mandated and for which instruments?**

96. The argument of procyclicality stress above and the need to set margins in a conservative manner, also applies to the determination of the historical lookback period. The longer the period under consideration, the most likely it will include stress market conditions and if stress market conditions are considered in the lookback period, the most conservative will be the determination of the actual margins requirements.

97. As mentioned above, keeping it fix the overall risk the CCP should withstand with the financial resources at its disposal, the higher the margins requirements, the lower the default fund contributions. This would lead to the negative consequences highlighted above of an unbalanced distribution of financial resources at the CCP disposal.

98. Against this background, ESMA is considering three possible options:

- a. Initial margins are calculated taking into account only the most recent margin conditions and therefore the historical lookback period is a fixed time period of one/two years;
- b. Initial margins are calculated taking into account a relatively long time period, e.g. 10 years. This approach would be more likely to include stressed market conditions, although would not necessarily weight these conditions appropriately if they occurred long ago.
- c. Initial margins are calculated on the basis of both stable and stress market conditions, but both are equally weighted

**Q35: Taking into account both the avoidance of procyclicality effects and the need to ensure a balance distribution of the financial resources at the CCP disposal, what is in your view the preferred option for the calculation of the lookback period.**

99. With reference to the liquidation period, ESMA considers that a prescriptive approach defined by class of financial instruments will help ensure consistency and harmonisation among different CCP margin models, thus limiting the risk of competition on risk management grounds. In this respect ESMA considers that a table as included in Annex I could help defining the appropriate minimum liquidation periods.

100. Although minimum liquidation periods are calculated in a detailed manner, ESMA considers that a criteria based approach should always apply and should take into account the following factors for the determination of the liquidation period:

- a. The longest possible period that may elapse since the last collection of margins up to the declaration of default by the CCP (or activation of the CCP's default management procedures).
- b. The estimated period needed to determine and execute the default management strategy according to the particularities of each class of financial instrument and the markets the CCP will use to close-out or hedge completely an average clearing member position.

**Q36: Is in your view the approach described above for the calculation of the liquidation period the appropriate one? Should a table with the exact number of days be included in the technical standards? Should other criteria for determining the liquidation period be considered?**

**Q37: Is procyclicality duly taken into account in the definition of the margin requirements?**

101. With reference to portfolio margining, such reference has been added at a later stage of the negotiation and ESMA is at a very early stage of its analysis.

#### **Default fund (Article 40)**

102. Under the RTS on default fund, ESMA is required to specify the framework for the definition of the extreme but plausible conditions the default fund should withstand.

103. Margins together with default fund contributions should be sufficient to withstand the default of the largest clearing member or the second and third largest under extreme but plausible market conditions. ESMA considers that the framework for the determination of such extreme but plausible market conditions CCP should at least include the following:

- a. Consideration of a range of scenarios (including a severe market downturn scenario) that are calibrated against the most adverse movements in risk drivers experienced over a historical period. The historical period should be determined by reference to each of the markets and products for which the CCP offers clearing services
- b. Consideration of both historical and hypothetical events in identifying market conditions that can be regarded as extreme but plausible
- c. Delineation between different types of products and markets (e.g. OTC versus exchange-traded, derivatives versus cash products) for the purpose of defining extreme but plausible scenarios.

- d. Consideration of scenarios that are based on both quantitative and qualitative assessments of potential market conditions
  - e. Both macroeconomic (systemic) and specific risk factors and the corresponding trigger events
  - f. Market conditions which include at least the identification of key risk drivers influencing the development and forecast of an event
  - g. Identification of the degrees of severity and frequency of occurrence of the identified market conditions
  - h. Robust analysis and justification where a historical event is no longer considered plausible by the CCP.
104. When defining types of extreme but plausible scenarios CCPs should consider all the risk factors they have assessed in the margin calculations, including:
- a. Interest rate risk
  - b. Foreign exchange risk
  - c. Credit risk; and
  - d. Liquidity risk.
105. With respect to risk drivers, the following should be included:
- a. All material risk types and risk drivers relevant to the CCP;
  - b. Interdependencies and possible confluences of events;
  - c. Potential changes in market conditions;
  - d. Sensitivity of exposures, especially with respect to concentration; and
  - e. The impact on applied correlations between instruments and/or across markets
106. There are a number of events which can trigger extreme but plausible market conditions. In identifying such events, at least the following triggers should be captured within the framework:
- a. Political events;
  - b. Natural disasters;
  - c. Economic developments;
  - d. Regulatory events; and
  - e. Correlations within or across risk drivers.

**Q38: What is your view of the elements to be included in the framework for the definition of extreme but plausible market conditions?**

#### **Liquidity risk controls (Article 41a)**

107. With reference to liquidity risk controls requirements, ESMA is required to develop technical standards specifying the framework for managing liquidity risk. ESMA will therefore have a quite broad

mandate with respect to liquidity risk controls and it is considering developing it in the manner set out in the following paragraphs.

108. CCPs should effectively identify, measure and monitor their settlement and funding flows on an on-going and timely basis, including intraday liquidity usage. In doing so, they should consider all liquidity risks they face in case the CCP itself, its clearing members or other entities cannot settle their payment obligations when due as part of the clearing or settlement process. The CCP's liquidity risk management framework should address the liquidity needs stemming from a clearing member's failure to meet its obligations and take into account the investment activity of the CCP. It should also address liquidity needs stemming from the CCP's relationships/links with at least the following: a) settlement agents; b) payments systems; c) securities settlement systems; d) nostro agents; e) custodian banks; f) liquidity providers; g) interoperable CCPs; h) service providers; and any other entity toward which the CCP has a liquidity exposure.
109. With reference to the entities listed above, the CCP should: i) consider interdependencies and multiple relationships; ii) manage concentration of liquidity exposures; and iii) strictly limit interdependencies or multiple relationships with parents or subsidiaries of the CCP or of its clearing members. The CCP should also measure its exposure to single clearing members (which should be lower than 25% according to EMIR) and establish concentration limits taking into account exposure to parent and subsidiary entities of clearing members and the including the following types of exposure: i) credit lines; ii) certificate of deposit; iv) savings accounts; v) deposit accounts; vi) current accounts; and vii) reverse repurchase facilities.
110. CCPs should maintain a liquidity plan specifying how the CCP intends to be able to determine on a daily basis the value of the available liquid assets and including at least the relevant information on how the CCP intends to: i) identify sources of liquidity risk; ii) measure and monitor, at least on a daily basis, its liquidity needs across a range of market scenarios; iii) proceed in the event of liquidity shortfalls; iv) maintain sufficient liquid financial resources to cover its liquidity needs in case of a default of at least the two clearing members to which it has the largest exposures; v) replenish any liquid financial resources it may employ during a stress event. The liquidity plan should be approved by the Board following the consultation of the risk committee.
111. CCPs should be required to effect same-day and, where appropriate, intraday settlement of payment obligations with a high degree of confidence and under a wide range of potential stress scenarios, including, but not limited to the simultaneous or successive default of the two clearing members to which it has the largest liquidity exposures under stressed market conditions and the liquidity risk generated by its investment policy and procedures. A CCP should assess its current and potential future liquidity needs on a daily basis, perform regular stress tests of its liquidity needs and test its procedures to access prearranged funding arrangements.
112. ESMA also considers that only financial resources that can be used for same-day payments should be counted as part of a CCP's liquid financial resources on a particular day. In particular, savings accounts, deposit accounts, current accounts, pledge and reverse repurchase facilities should be counted as part of its liquid financial resources if they are claims on:
- (a) the central bank of the jurisdiction where the CCP is established;
  - (b) a central bank of issue of a currency in which the CCP has exposures; or

- (c) a credit institution that has a low credit risk (also considering the risk arising from the establishment of the credit institution in a particular country) and to which the CCP has prompt access when required.

Credit lines should only be counted as part of a CCP's liquid financial resources where these are committed and provided by a central bank or an authorised credit institution which the CCP can demonstrate has strong processes, systems, and low credit risk based upon a stable and objective internal or external assessment. Such committed lines of credit when provided against collateral provided by clearing members should not be double counted as liquid resources.

**Q39: Do you believe that the elements outlined above would rightly outline the framework for managing CCPs' liquidity risk?**

**Q40: Do you consider that the liquid financial resources have been rightly identified? Should ESMA consider other type of assets, such as time deposits or money market funds? If so, please provide evidences of their liquidity and minimum market and credit risk.**

113. To avoid over reliance of a CCP on liquidity provisions by credit institutions or, where available, by central banks and to avoid a continuous disinvestment of liquid resources when the CCP need to settle its obligations, ESMA could envisage requiring the CCP to maintain a minimum amount of liquid assets in the form of cash.

**Q41: Should the CCP maintain a minimum amount of liquid assets in cash? If so, how this minimum should be calculated?**

#### **Default waterfall (Article 42)**

114. Under the RTS for the default waterfall, ESMA is required to specify the methodology for calculation and maintenance of CCPs' own resources to be used in a default situation before the resources of the non-defaulting clearing members can be mutualised, i.e. so called skin in the game. For the determination of such an amount, ESMA is considering the following two options:

- a. [X%] of the average amount of the margins and default fund contributions collected by the CCP over a one year period (excluding margins posted by interoperable CCPs);
- b. [X%] of the CCP's total capital resources as requested in accordance to Article 12 of EMIR, whose details would need to be specified through RTS to be developed by EBA.

115. Option a) would have the following advantages: i) it is agnostic as to the weight that the CCP risk model puts on margins vs default fund contributions. ESMA has considered weighting the default waterfall only on margins or on the default fund contributions, but has considered that if only one of the two measures were to be adopted then CCPs might have an incentive to increase the other measure to lower their contribution to the default waterfall; ii) it is based on the actual risk the CCP faces while performing clearing activities, although it presents some procyclical disadvantages given that as margins and default fund contributions rise in stressed market conditions, then the resources that the CCP needs to finance the skin in the game would also rise). The size of this problem could be limited by the request of an average contribution over the course of one year. This would imply also an annual re-

assessment of the CCP's contribution, instead of continuous re-assessments. Such less-frequent calculation would help maintaining the level of the skin in the game more stable over time, which is an essential element of it, given that the CCP cannot raise its capital on a continuous basis. Margins and default fund contributions posted by interoperable CCPs would be excluded from the calculation on the basis of the fact that they are not clearing members and also to prevent the introduction of contagion risk. Furthermore, if the CCP maintains different default funds, the sum of those should be considered for the calculation of the skin in the game.

116. Option b) has the advantage of being more stable over time, yet still commensurate to the size of the CCP. It would not however, be related to counterparty credit risk, which is what participation by the CCP in the default waterfall is intended to address.

117. ESMA also considers that: a) in the case that the dedicated resources of a CCP fall below the required level, then the CCP should replenish them within one month; b) in the case that a subsequent default of one or more clearing members occurs before the CCP has replenished the amount due, only the residual amount of the CCP's dedicated own resources would be required to be used; c) in case the CCP has established different default funds, each one dedicated to a separate market segment, the CCP is allowed the faculty to segregate correspondently different portions of the total own resources dedicated to the default waterfall. In this case, each portion would be used only for defaults occurring in a specific market segment.

**Q42: What is your preferred option for the determination of the quantum of dedicated own resources of CCPs in the default waterfall? What is the appropriate percentage for the chosen option? Should in option a, the margins or the default fund have a different weight, if so how? Should different criteria or a combination of the above criteria be considered?**

**Q43: What should be the appropriate frequency of calculation and adaptation of the skin in the game?**

### **Collateral requirements (Article 43)**

118. Under the RTS for collateral, ESMA is required to define the type of collateral that can be considered highly liquid. Under the Collateral RTS, ESMA is also required to define the conditions under which commercial bank guarantees may be accepted as collateral. ESMA's preliminary thinking is that a criteria based could envisage taking into account the currency, the depository institution used, the transferability, credit and market risk, the existence of a liquid and diversified market and the absence of procyclicality or wrong way risk. The alternative would be a prescriptive approach which would have the drawbacks of being inflexible and difficult to define across types of products and CCPs.

119. The degree to which collateral is subject to wrong-way risk is considered to be important because a CCP's collateral pool needs to be capable of rapid liquidation with minimal loss at such time that a CCP needs to employ the collateral. Where collateral is subject to material wrong-way risk, for example where its value is highly correlated with the credit risk of a clearing member, then there is a possibility that the collateral will be subject to a reduction in value upon the default of that clearing member. Upon liquidation, the CCP would be left with a reduced amount of financial resources with which to cover the defaulted clearing member's losses.

120. In the case of cash or financial instruments in particular a criteria based approach could envisage that an asset is only highly liquid where it meets the following factors:

- 1) In the case of cash, that which is deposited with (i) an EEA central bank or a central bank of issue of the currency and to which the CCP has prompt access when required; or (ii) cash which is deposited with a credit institution that has a low credit risk (also considering the risk arising from the establishment of the credit institution in a particular country) and to which the CCP has prompt access when required.
- 2) In the case of financial instruments, assets which (i) have been issued by an issuer with low credit risk (taking into consideration also the risk arising from the establishment of the issuer in a particular country) (ii) have low market risk; (iii) are freely transferable without any regulatory or legal constraint that impairs liquidation; (iv) have an active outright sale or repurchase agreement market at all times including a diverse group of buyers and sellers; (v) have price data published on a regular basis and (vi) those which are not subject to material wrong-way risk or not issued by:
  - (a) the clearing member, or the parent or subsidiary of the clearing member;
  - (b) an entity whose business involves providing essential services to the CCP unless that entity is an EEA central bank or a central bank of issue of a currency in which the CCP has exposures;
  - (c) an entity whose exclusive purpose is to own means of production that are essential for a clearing member's business; or
  - (d) not issued by an entity whose exclusive purpose is to own or to manage real property that is used by the clearing member or the CCP.
- 3) In the case of commercial bank guarantees, guarantees which (i) are issued to guarantee a non financial clearing member; (ii) have been issued by an issuer which have a low credit risk (taking into consideration the risk arising from the establishment of the issuer in a particular country); (iii) are irrevocable, unconditional and the issuer can not rely on any legal or contractual exemption or defence to oppose the payment of the guarantee; (iv) can be honoured within the period of liquidation the portfolio of the defaulting clearing member providing it without any regulatory, legal or operational constraint; (v) fully backed by collateral that is realisable on a same-day basis and (vi) those which are not subject to material wrong-way risk or not issued by:
  - (a) the clearing member, the parent or a subsidiary of the clearing member;
  - (b) an entity whose business involves providing essential services to the CCP unless that entity is an EEA central bank or a central bank of issue of a currency in which the CCP has exposures;
- 4) In the case of guarantees issued by a central bank, guarantees which (i) are issued by an EEA central bank or a central bank of issue of a currency in which the CCP has exposures; or (ii) are irrevocable, unconditional and the central bank issuer can not rely on any legal or contractual exemption or defence to oppose the payment of the guarantee; or (iii) can be honoured within the period of liquidation the portfolio of the defaulting clearing member providing it without any regulatory, legal or operational constraint.
- 5) In the case of gold, allocated pure gold bullions of recognised good delivery which are (i) deposited with an EEA central bank or a central bank of issue of a currency in which the CCP has exposures and to which the CCP has prompt access when required; or (ii) deposited with a credit institution, that has a low credit risk (also considering the risk arising from the establishment of the credit institution in a particular country) and to which the CCP has prompt access when required.

**Q44: Do you consider that financial instruments which are highly liquid have been rightly identified? Should ESMA consider other elements in defining highly liquid collateral in respect of cash of financial instruments? Do you consider that the bank guarantees or gold which is highly liquid has been rightly identified? Should ESMA consider other elements in defining highly liquid collateral in respect of bank guarantees or gold?**

121. It should be noted that the criteria above restrict the acceptance of collateral issued the clearing member providing it, but allows the possibility for a clearing member to post collateral issued by another clearing member. This might provide an incentive to clearing members to cross-collateralise<sup>2</sup> their exposures, with huge risks for the CCP.

122. Although the CCP should not be responsible for monitoring the financing practices among clearing members, such cross-collateralisation practice should not be allowed. To protect itself from such practice the CCP should ensure a close monitoring to the wrong way risk to which the acceptable collateral should be subject to.

123. Notwithstanding this potential risk, ESMA preliminary view is that CCP should be allowed to accept collateral issued by other clearing members.

124. As for the collateral issued by the clearing member posting it, it should be noted that the consultative report of the CPSS-IOSCO Principles for financial markets infrastructures allows it in the case of cover bonds under the restrictive conditions that the underlying of the cover bond: 1) is appropriately segregated by the issuer from its own assets; 2) complies with the requirements for acceptable collateral as listed above.

**Q45: In respect of the proposed criteria regarding a CCP not accepting as collateral financial instruments issued by the clearing member seeking to lodge those financial instruments, is it appropriate to accept covered bonds as collateral issued by the clearing member?**

125. Furthermore, ESMA's preliminary thinking is that a criteria based approach for defining highly liquid collateral could envisage that cash, financial instruments or bank guarantees are only highly liquid where they are denominated in (i) the currency of the jurisdiction where the CCP is established; (ii) the currency of a State which the CCP can demonstrate with a high level of confidence that it is able to manage the risks on the currency; or (iii) the currency in which the CCP clears business in the limit of the collateral required to cover the CCP's exposures in that currency.

**Q46: Do you consider that the proposed criteria regarding the currency of cash, financial instruments or bank guarantees accepted by a CCP have been rightly identified in the context of defining highly liquid collateral? Should ESMA consider other elements in defining the currency of cash, financial instruments or bank guarantees accepted by a CCP as collateral? Please justify your answer.**

126. Under the RTS for collateral, ESMA is required to define the haircuts that a CCP shall apply to collateral to reflect the potential for its value to decline over the interval between its last revaluation

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<sup>2</sup> Such cross-collateralisation would imply that clearing members would create financial instruments for the purpose of financing one another.

and the time by which it can reasonably be assumed to be liquidated. ESMA's preliminary thinking is that a CCP should establish and implement policies and procedures to determine prudent haircuts to apply on collateral value. In particular, ESMA considers that a CCP should apply haircuts taking into account the liquidation period determined for the purpose of the calculation of margins.

127. The degree to which haircuts are subject to procyclicality is considered to be important because it impacts the CCPs, clearing members and the financial system as a whole. Where haircuts are subject to procyclicality, for example where the haircuts on a financial instrument accepted as collateral increase during times of market volatility, then there is a possibility that clearing members will be unable to fund the additional collateral required to be posted to the CCP in order to meet the CCP's margin calls. This in turn could lead to the clearing member (a) having to liquidate other assets, or (b) defaulting, which in turn could increase market volatility and further increase the risk that other clearing members will be unable to meet their margin calls and default. To limit this procyclical effect, margins should be calculated in a conservative manner, so that continuous adjustments are not necessary in stressed market conditions.

128. Against this background, ESMA considers important that haircuts are sufficiently prudent so that collateral can be liquidated without significant market impact in stressed market conditions and that they are calculated in a conservative manner to limit procyclical effects and wrong-way risk. In this regard, ESMA's preliminary thinking is that haircuts should be determined taking into consideration criteria such as the type of asset, the level of credit risk of the financial instrument and/or the issuer, the maturity and liquidity of the security, and the price volatility of the asset and of the market over a period which should cover, at a minimum, ten years and possibly incorporate stressed market conditions.

**Q47: Do you consider that the elements outlined above would rightly outline the framework for determining haircuts? Should ESMA consider other elements?**

129. ESMA's preliminary thinking is that on an ongoing basis, a CCP should establish and implement policies and procedures to assess the adequacy of its haircuts. These reviews should not be mechanical and avoid introducing procyclicality, where possible. ESMA's preliminary thinking is that in conducting such an assessment, a CCP should take into account the credit quality, market liquidity and the price volatility of accepted collateral.

**Q48: Do you believe that the elements outlined above would rightly outline the framework for assessing the adequacy of its haircuts? Should ESMA consider other elements?**

130. ESMA's preliminary thinking is that a CCP should establish and implement policies and procedures to ensure that collateral it has accepted remains sufficiently diversified to allow for its liquidation within the defined holding period without a significant market impact therefore making the pool of collateral available to the CCP less exposed to market volatility and procyclical effects. In particular, ESMA's preliminary thinking is that a CCP should evaluate the concentration of collateral provided in the form of financial instruments of an individual issuer, type of issuer (in terms of economic sector, activity, geographic region, or rating), type of asset or in the form of commercial bank guarantees. In order to avoid a high credit exposure to an individual issuer, type of issuer or type of asset, ESMA's preliminary thinking is that a CCP should determine concentration limits at the level of each clearing member and at the level of all clearing members.

131. When determining the concentration limit for a CCP's exposure to an individual issuer, ESMA considers that a CCP should aggregate together and treat as a single risk, exposure to all financial

instruments issued by an individual issuer, the commercial bank guarantee provided by the issuer, explicitly guaranteed by that issuer (reference to the issuer is considered to include the parent or subsidiaries of that issuer).

132. In order to limit the potentially procyclical effects of haircuts on financial instruments and to ensure that a CCP is able to employ collateral provided by a clearing member rapidly, ESMA's preliminary thinking is that a CCP should require a minimum proportion of collateral from each clearing member to be provided in the form of cash. ESMA's preliminary thinking is also that commercial bank guarantees should not cover more than a maximum proportion of the collateral requirements of a particular clearing member.

**Q49: Do you consider that the elements outlined above would rightly outline the framework for determining concentration limits? Should ESMA consider other elements?**

**Q50: Should a CCP require that a minimum percentage of collateral received from a clearing member is provided in the form of cash? If yes, what factors should ESMA take into account in defining that minimum percentage? What would be the potential costs of that requirement?**

#### **Investment policy (Article 44)**

133. Under the RTS for Investment Policy, ESMA is required to define highly liquid financial instruments with minimal market and credit risk, the highly secure arrangement for the deposit of cash and other assets and the concentration limits to individual obligors. ESMA's preliminary thinking is that financial instruments in which a CCP invests need to be capable of being liquidated rapidly and with minimal adverse price effect. ESMA's preliminary thinking is that in defining the conditions that financial instruments should meet to be considered highly liquid with minimal market and credit risk, a criteria-based approach is preferable to the definition of a list of financial instruments as it ensures that the prescribed standard is flexible and remains relevant and applicable.

134. ESMA's preliminary thinking is that the criteria for defining financial instruments that are highly liquid with minimal market and credit risk should be more restrictive than the criteria for defining the highly liquid collateral that a CCP can accept (see section on collateral). The reason for such differentiation being that the CCP will not be able to apply haircuts on the financial instruments in which it invests as it is the case for the collateral received. In particular, ESMA's preliminary thinking is that it is necessary to prescribe a restrictive standard concerning the issuer of the financial instrument, the transferability of the financial instrument and the credit, market, volatility, inflation, maturity and foreign exchange risk of the financial instrument.

135. ESMA's preliminary thinking is therefore that a criteria based approach could envisage that an asset is only highly liquid with minimal market and credit risk where it meets the following factors:

- 1) In the case of financial instruments, debt instruments which (i) have low credit risk, market risk, volatility and inflation risk; (ii) do not have an average duration greater than a specific timeframe; (iii) are freely transferable and without any regulatory or legal constraint that impairs liquidation; (iv) have an active outright sale or repurchase agreement market at all times with a diverse group of buyers and sellers; (v) have price

data published on a regular basis; (vi) are not subject to material wrong-way risk with respect to clearing members; and (vii) have been issued or are explicitly guaranteed by:

- a) a government of a country that the CCP can demonstrate with a high degree of confidence that it has a low credit risk;
  - b) a central bank of issue of a currency in which the CCP has exposures; or
  - c) a multilateral development bank which the CCP can demonstrate with a high degree of confidence that has a low credit risk;
- 2) In the case of cash equivalent financial instruments, certificates of deposit, savings accounts and current accounts which are claims on:
- a) the central bank of the jurisdiction where the CCP is established;
  - b) a central bank of issue of a currency in which the CCP has exposures; or
  - c) a credit institution that has a low credit risk (also considering the risk arising from the establishment of the credit institution in a particular country) and to which the CCP has prompt access when required.

136. Furthermore, ESMA considers that to prevent wrong way risk and an excessive exposure of CCPs to credit institutions, cash and cash equivalent financial instruments should be maintained in a secured form, thus allowing the CCP to access them in case of the default of the counterparties where these assets are maintained. To ensure that, a limit to the amount of cash that can be maintained in an unsecured<sup>3</sup> form could be considered.

137. ESMA also considers that CCPs should, in principle, not be allowed to invest in derivatives to hedge their interest rate, currency, or other exposures. The investment in derivatives would expose the CCP to additional risks which are not typical of the clearing activity. Potentially, certain CCPs (e.g. those with a banking licence) investing in derivatives could even be subject to the clearing obligation, thus further exposing the CCP to additional complexity. However, it could be envisaged that in exceptional situations, e.g. as part of a default management, CCPs could be allowed to enter into derivatives transactions for the purpose of the proper management of the default.

**Q51: Do you consider that financial instruments and cash equivalent financial instruments which are highly liquid with minimal market and credit risk have been rightly identified? Should ESMA consider other elements in defining highly liquid financial instruments with minimal market and credit risk? What should be the timeframe for the maximum average duration of debt instrument investments?**

**Q52: Do you think there should be limits on the amount of cash placed on an unsecured basis?**

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<sup>3</sup> Unsecured in this context is not referred to the creditworthiness of the counterparties, but to the form in which cash or cash equivalent instruments are maintained, e.g. in case of reverse repo transactions, the CCP will have the cash secured by financial instruments underlying the transaction, whereas if the cash is maintained in a deposit with a credit institution, the default of that credit institution will expose the CCP to a loss.

**Q53: Do you consider that CCP should be allowed to invest in derivatives for hedging purposes? If so, under which conditions and limitations.**

138. Furthermore, ESMA's preliminary thinking is that a criteria based approach for defining highly liquid financial instruments with minimal market and credit risk could also envisage that financial instruments and cash equivalent financial instruments are only highly liquid where they are denominated in (i) the currency of the jurisdiction where the CCP is established; (ii) the currency of a State which the CCP can demonstrate with a high level of confidence that it is able to manage the risks on the currency; or (iii) a currency in which the CCP clears business, in the limit of the collateral received in that currency.

**Q54: Do you consider that the proposed criteria regarding the currency of financial instruments in which a CCP invests has been rightly identified in the context of defining highly liquid financial instruments with minimal market and credit risk? Should ESMA consider other elements in defining the currency of highly liquid financial instruments with minimal market and credit risk? Please justify your answer.**

139. Under the RTS for Investment Policy, ESMA is required to prescribe a framework for determining the highly secured arrangements in respect of which financial instruments lodged by clearing members are deposited. ESMA's preliminary thinking is that it is important that financial instruments posted to a CCP as margins or as default fund contributions are deposited in such a manner so as to ensure the full protection of those instruments and to enable a CCP to access such financial instruments in a timely manner.

140. ESMA's preliminary thinking is that a CCP should at first instance deposit financial instruments lodged by clearing members with the operator of an EU securities settlement system that ensures the full protection of those instruments. Where a CCP is unable to do so, ESMA's preliminary thinking is that such financial instruments should be deposited with:

- (a) an European central securities depository;
- (b) the operator of a third country security settlement system or central securities depository that (i) will fully protect the financial instruments; (ii) is supervised and regulated; (iii) has robust accounting practices, safekeeping procedures, and internal controls; (iv) has a low credit risk (taking into consideration the risk arising from the establishment of the security settlement system in a particular country) and (v) to which the CCP has prompt access to when required;
- (c) the central bank of issue of a currency in which the CCP has exposures and to which the CCP has prompt access when required; or
- (d) a credit institution that has a low credit risk (also considering the risk arising from the establishment of the credit institution in a particular country) and to which the CCP has prompt access when required.

**Q55: Do you consider that the elements outlined above would rightly outline the framework for determining the highly secured arrangements in respect of which financial instruments lodged by clearing members should be deposited? Should ESMA consider other elements? Please justify your answer.**

141. Under the RTS for Investment Policy, ESMA is required to prescribe a framework for determining appropriate concentration limits in respect of the investments made by a CCP. ESMA's preliminary thinking is that it is important that a CCP ensures that the effectiveness of its measures taken to limit the credit, market, maturity or foreign exchange risk exposure of its investments is enhanced by adequate diversification.

142. In particular, ESMA's preliminary thinking is that a CCP should establish and implement policies and procedures to ensure that its financial resources remain sufficiently diversified and determine concentration limits at the level of, and monitor the concentration of its financial resources invested in (i) individual financial instruments; (ii) types of financial instruments; (iii) individual issuers; and (iv) types of issuer.

143. When considering types of issuer, ESMA's preliminary thinking is that a CCP should take into account a number of factors, including (a) geographic distribution; (ii) economic or legal interdependence; and (level of credit risk). Furthermore, when determining the concentration limit for a CCP's exposure to an individual issuer or custodian, ESMA's preliminary thinking is that a CCP should aggregate together and treat as a single risk, exposure to all financial instruments issued by and explicitly guaranteed by an issuer and all financial resources deposited with a custodian.

**Q56: Do you consider that the elements outlined above would rightly outline the appropriate framework for determining concentration limits? Should ESMA consider other elements? Please justify your answer.**

#### **Review of models, stress testing and back testing (Article 46)**

144. Under the RTS for Review of models, stress and back testing, ESMA is required to specify a) the types of tests to be undertaken for different classes of financial instruments and portfolios; b) the involvement of clearing members or other parties in the tests; c) the frequency of tests; d) the time horizons of tests; and e) the key information a CCP shall publicly disclose on its risk management model and assumptions adopted to perform its stress tests. ESMA considers that it is necessary to adopt a criteria based approach to cater for the wide range of security and derivative products which may be cleared in the future, reflect differences in a CCP's business and risk management approaches, allow for future developments and new risks to be dealt with and allow for sufficient flexibility.

145. ESMA considers that for the purposes of this standard back testing should be defined as the ex-post comparison of the measure generated by a CCP margin model against actual daily changes in mark-to-market values of clearing members' positions/portfolio over a specified period of time, and stress testing should be defined as the estimation of credit and liquidity exposures that would result from the realisation of severe, including extreme but plausible market conditions.

**Q57: What are your views on the definitions of back and stress testing?**

### Model Validation:

146. ESMA believes that the tests a CCP conducts are essential to assess the validity and accuracy of its risk management model and the adequacy of its financial resources coverage. ESMA therefore considers that a CCP should document its validation process detailing, at minimum, the stress and back testing policies it will use to test its margin, default fund and other financial resources methodologies, and any material revisions or adjustments to such policies should be subject to appropriate governance and validated by a qualified and independent party prior to application. The validation process, which should be documented, should also detail the criteria against which a CCP's risk management model would be considered successfully validated, at minimum this would include successful stress and back testing results.
147. ESMA considers that in conducting a comprehensive full validation of its risk management model a CCP should, at minimum, review i) the parameters and assumptions made in the development of its models and methodologies; ii) the adequacy and appropriateness of the models and methodologies adopted in respect of the types of contracts they apply to; and iii) the appropriateness of its stress scenarios (used when stress testing). Further, ESMA considers that any material revisions or adjustments to its risk management model should be subject to appropriate governance and validated by a qualified and independent party prior to application. ESMA considers that such a party could be internal, provided the party has sufficiently separate reporting lines and is separate from the development of the models, or external.
148. ESMA considers that a CCP's stress and back testing policies should detail the testing programs it will undertake to assess the appropriateness, accuracy, reliability and resilience of the models and methodologies used to calculate its financial resources including margin, default fund contributions and other financial resource requirements in a wide range of market conditions. The policies and procedures should include at least the methodologies for the inclusion of: the selection and development of appropriate testing, including portfolio and market data selection, the regularity of the tests, the specific risk characteristics of the products cleared, the analysis of testing results and exceptions (where the model did not perform as expected) and the relevant corrective measures needed.
149. The testing programs should be used to ensure that a CCP's margin model's actual coverage, along with projected measures of its performance, meet at least the required confidence interval until the end of the liquidation period over a period of time for at least:
- (a) all contracts cleared by the CCP;
  - (b) clearing member portfolios;
  - (c) where applicable client portfolios cleared by the CCP; and
  - (d) where relevant interoperable CCPs.
150. The testing programs should also be designed so that a CCP regularly conducts an assessment of the theoretical and empirical properties of its margin model for all contracts it clears.

### **Q58: What are your views on the possible requirements for a CCP's validation process?**

#### Back tests:

151. ESMA considers that a CCP should conduct back tests to validate its margin models, and the models that input into it, ensuring sufficient margin coverage in line with paragraph 142 above. In respect of a CCP's back testing programs, ESMA considers that:

- (a) A CCP should, as an integral part of its evaluation, assess its margin coverage by back testing its models to calculate its initial margins against actual market changes and by back testing its models against identified targets using clearing member and, where appropriate, client positions from each day in order to evaluate whether there are any testing exceptions to its margin coverage. Coverage should be evaluated across products, clearing members and, where appropriate clients, and take into account portfolio effects across asset classes within the CCP.
- (b) A CCP should consider at least clear statistical tests, including a range of confidence intervals, and performance criteria to be defined for the assessment of back testing results.
- (c) A CCP should conduct historical back testing on a number of representative clearing member and, where appropriate, client portfolios, which are chosen based on their sensitivity to the material risk factors and correlations to which the CCP is exposed. Such back testing should be designed to test the key assumptions of the initial margin model at a number of confidence intervals, giving appropriate consideration to, at minimum, the term structure of the risk factors, and the assumed correlation between risk factors.
- (d) Back testing results and analysis should be periodically reported to the Risk Committee and made available to all clearing members and the CCP's back testing policy documents should define procedures detailing the actions it will take given the results of the back testing analysis.
- (e) The program should ensure that the CCP's back tests consider a range of appropriate historical time horizons to ensure that the observation window used is sufficient enough to mitigate any suffering of the statistical significance. The historical time horizons considered should take into account the lookback period defined for margin.

152. In respect of 144(d), ESMA considers that while disclosing back testing results and analysis to clients would provide for additional transparency, it could cause confidentiality issues to arise and that consideration should be given to the conditions under which such information would need to be disclosed.

**Q59: What are your views on the possible back testing requirements?**

**Q60: Would it be appropriate to mandate the disclosure of back testing results and analysis to clients if they request to see such information?**

**Q61: Should the time horizons for back tests specified under 144(e) be more granular? If so, what should the minimum time horizon be? Should this be different for different classes of financial instruments?**

Stress tests:

153. ESMA considers that a CCP should conduct stress tests to ensure sufficient coverage of its combination of margin, default fund contributions and other financial resources in line with (d) below, in extreme but plausible market conditions, and to validate its risk management model (specifically the

models determining its margin, default fund contributions and other financial resources). In respect of a CCP's stress testing programs, ESMA considers that:

- (a) A CCP should conduct a range of stress tests regularly and consider the CCP's product mix and all elements of its risk management model. The program should test critical parameters, some of which are mentioned below, and assumptions made in the CCP's risk methodologies to determine the sensitivity of the system to errors in the calibration of such parameters and assumptions.
- (b) The program should prescribe that stress tests are performed on positions and on both past and hypothetical extreme but plausible market conditions. The CCP's stress tests should also have the capacity to adopt its stress tests quickly to incorporate new or emerging risks. Past conditions shall be reviewed and adjusted where appropriate.
- (c) Stress testing results and analysis should be periodically reported to the Risk Committee and made available to all clearing members and the CCP's stress testing policy documents should define procedures detailing the actions it will take given the results of the stress testing analysis.
- (d) The program should at least ensure that the CCP's combination of margin, default fund contributions and other financial resources are sufficient to cover the total exposure arising from the default of the largest clearing member and the greater of the simultaneous or subsequent default of the second largest clearing member, and their parent companies and/or subsidiaries, to which the CCP has the largest exposures and, where appropriate, related clients accounts, including in extreme but plausible market conditions. Separately the program should at least ensure that the CCP's default fund contributions are sufficient to provide full coverage in line with Article 40 of EMIR. Stress tests should also consider in the default management process the liquidation period, outlined in Article 30 of EMIR, needed to close out the positions of relevant clearing member(s) and clients(s), considering different liquidation periods for different financial instruments.
- (e) The program should define a set of stress scenarios that the CCP will use to conduct its stress tests. The CCP should conduct a thorough analysis of the potential losses it could suffer in a variety of extreme but plausible market conditions, evaluating potential losses in individual clearing member positions, as well as their clients' positions, where appropriate, including the risk that liquidating such positions could have an impact on the market and the CCP's level of margin coverage.
- (f) A CCP that clears debt instruments or credit derivatives should consider in its stress tests the effects of the default of a clearing member that issues financial instruments cleared by the CCP or the underlying of derivatives cleared by the CCP. Where appropriate, the effects of a client's default that issues financial instruments cleared by the CCP or the underlying of derivatives cleared by the CCP should also be considered.
- (g) The program should ensure that stress tests cover historic data, including the most volatile periods experienced by the CCP for a particular product or a related product and other foreseeable price-sensitive events, including other forward looking extreme but plausible market conditions.

154. Similarly to above in respect of 146(c), ESMA considers that while disclosing stress testing results and analysis to clients would provide for additional transparency, it could cause confidentiality issues to arise and that consideration should be given to the conditions under which such information would need to be disclosed.

Risk factors (stress tests):

155. ESMA considers that a CCP's stress tests should identify and have an appropriate method for measuring relevant risk factors specific to the contracts the CCP clears that could affect its losses. At minimum, and where applicable, a CCP's stress tests should take appropriate consideration of:

- (a) In respect of interest rate related contracts: risk factors corresponding to interest rates in each currency in which the CCP clears products. The yield curve modelling should be divided into various maturity segments in order to capture variation in the volatility of rates along the yield curve. The number of related risk factors should depend on the complexity of the interest rate products cleared by the CCP. Basis risk, arising from less than perfectly correlated movements between government and other fixed-income interest rates, should be captured separately.
- (b) In respect of exchange rate related contracts: risk factors corresponding to each foreign currency in which the CCP clears products and to the exchange rate between the currency in which margin calls are made and the currency in which the CCP clears its products.
- (c) In respect of equity related contracts: risk factors corresponding to the volatility of individual equity issues for each of the markets cleared by the CCP and to the volatility of various sectors of the overall equity market, the sophistication and nature of the modelling technique for a given market should correspond to the CCP's exposure to the overall market as well as its concentration in individual equity issues in that market.
- (d) In respect of commodity contracts: risk factors that consider the different categories and sub-categories of commodity products and related derivatives cleared by the CCP, including, where appropriate, variations in the convenience yield between derivatives positions and cash positions in the commodity.
- (e) In respect of credit related contracts: risk factors that consider jump to default risk, including the cumulative risk arising from multiple defaults, basis risk and recovery rate volatility.

156. Additionally ESMA considers that a CCP should give appropriate consideration to the following in its stress tests:

- (a) Correlations, including those between identified risk factors and similar contracts cleared by the CCP;
- (b) Factors corresponding to the implied and historical volatility of the contract being cleared;
- (c) Specific characteristics of any new contracts to be cleared by the CCP;
- (d) Concentration risk, including to a clearing member and, where appropriate, clients, and/or groups of clearing members/clients; and
- (e) Wrong-way risk.

**Q62: What are your views on the possible stress testing requirements?**

**Q63: Would it be appropriate to mandate the disclosure of stress testing results and analysis to clients if they request to see such information?**

157. Additional to the stress testing outlined above, ESMA considers that:

- (a) A CCP should conduct reverse stress tests aimed at identifying the extreme scenarios and market conditions in which the combination of its margin, default fund contributions and other financial resources would provide insufficient coverage, such scenarios may go beyond extreme but plausible market conditions so as to help the CCP understand the sufficiency of its financial resources given the underlying assumptions modelled. The CCP should develop reverse stress tests tailored to the specific risks of the markets and of the contracts that it provides clearing services for and use the results and analysis to help identify extreme but plausible scenarios.
- (b) A CCP should also consider other forms of stress scenarios in conducting its testing including, but not limited to i) multiple simultaneous or sequential clearing member defaults, and where appropriate client defaults over various time horizons; ii) simultaneous pressures in funding and asset markets.; and iii) the technical or financial failure of the CCP's settlement banks, nostro agents, custodian banks, liquidity providers, or interoperable CCPs.

**Q64: What are your views on the possible requirements for reverse stress tests? And what impact do you think such requirements would have on industry?**

Testing results:

158. ESMA considers that a CCP should use its testing results to:

- (a) Identify if its margin model performed as expected and if its margin model does not identify the appropriate amount of margin necessary to achieve the intended level of confidence the CCP should have clear procedures to determine the amount of additional margin it may need to collect, to call the additional margin promptly, including on an intraday basis, and to recalibrate its margin model.
- (b) Evaluate the source of exceptions highlighted by its back tests. Depending on the source of these exceptions the CCP should determine if a fundamental change to the margin model, or the models that input into it, is warranted or if the recalibration of current parameters is necessary. In the interim before any changes are made the CCP should call any additional margin necessary to achieve full coverage.
- (c) Identify if its risk management model performed as expected and if not the CCP should have clear procedures to determine the amount of additional financial resource coverage it may need to collect, how it will increase its overall financial resource coverage promptly, including on an intraday basis, and to recalibrate any of its risk management models.
- (d) Evaluate the sources of exceptions highlighted by its stress tests. Depending on the source of these exceptions the CCP should determine if a fundamental change to its risk management model is warranted or if the recalibration of current parameters is necessary. In the interim before any changes are made the CCP should increase its overall coverage of its financial resources as necessary to an acceptable level promptly.

Involvement of parties in tests:

159. ESMA considers that a CCP should ensure that as a minimum the Risk Committee provides for appropriate representation of clearing members and clients, and that the Risk Committee are involved in the definition and review of all tests.

**Q65: Should there be any other parties involved in the definition and review of tests? Please justify your answer and explain the extent to which suggested parties should be involved?**

Testing of default procedures:

160. ESMA also considers that the testing of CCP default procedures is imperative to help identify any uncertainties and for transparency amongst CCP users. Therefore a CCP should establish a program to test and review its default procedures in order to ensure they are both practical and effective. If testing highlights any uncertainties the CCP should adapt its procedures appropriately to mitigate such uncertainty. Testing should involve all clearing members, where appropriate, clients and other relevant parties including, but not limited to, interoperable CCPs and any related service providers.

**Q66: Should the testing of default procedures involve a simulation process?**

Frequencies of tests:

161. Regarding the frequency of tests ESMA considers that:

- (a) A CCP should conduct a comprehensive full validation of its risk management model at least annually.
- (b) The appropriateness of the CCP's stress, back and other testing policies and models used to test its margin, default fund contributions and other financial resources methodologies should be reviewed at least annually.
- (c) A CCP should analyse and monitor its model performance and financial resources coverage in the event of defaults by i) back testing margin coverage daily; ii) conducting routine daily stress testing; and iii) conducting a detailed thorough analysis of testing results at least on a monthly basis in order to ensure its stress scenarios, models, underlying parameters and assumptions are appropriate.
- (d) A CCP should stress test more frequently in stressed market conditions including, but not limited to, when the products cleared or markets served in general display high volatility, become less liquid, or when the size or concentrations of positions held by its clearing members and, where appropriate, clients increase significantly or when it is anticipated that the CCP will encounter stressed market conditions.
- (e) The appropriateness of default procedures should be reviewed annually.

**Q67: Are the frequencies specified above appropriate? If no, please justify your answer.**

Information to be publicly disclosed:

162. Regarding public disclosure of information ESMA considers that a CCP should, at minimum, make the following key aspects of its default procedures available i) the circumstances in which action may be taken; ii) who may take those actions; iii) the scope of the actions which may be taken, including the treatment of both proprietary and client positions, funds and assets; iv) the mechanisms to address the CCP's obligations to non-defaulting clearing members; and v) the mechanisms to help address the defaulting clearing member's obligations to its clients.

**Q68: In your view what key information regarding CCP risk management models and assumptions adopted to perform stress tests should be publicly disclosed?**

### **III.III Trade Repositories**

163. In developing the draft technical standards on TRs, ESMA has sought to build on the few existing pieces of international work, notably the ODRF guidance on access to TR-held data, the *IOSCO-CPSS Report on OTC derivatives data reporting and aggregation requirements*, and proposed or adopted regulations of a number of third-countries, to ensure international consistency and reduce arbitrage. Where applicable, the draft CPSS-IOSCO Principles for financial market infrastructures, which are currently in the process of being finalised, have been considered to the extent they apply to TRs.

164. In many cases, these global standards are not specific enough for the level of granularity that draft technical standards are expected to take. In such circumstances, ESMA will need to introduce more stringent requirements that will still be compatible with the high level principles agreed at international level, to the extent consistent with the Regulation. This will ensure the consistency of the EU requirements with international standards, and should permit EU-based TRs to operate on a global basis, as well as third country TRs to be recognised in accordance with EMIR procedure. Progress has however been made in reducing these inconsistencies to the minimum and further efforts will follow when implementing the standards.

165. In addition, while drafting the RTS and ITS on TRs, ESMA is duly consulting the members of the ESCB, and the relevant authorities listed under Article 67 of EMIR.

#### **Reporting obligation (Article 6/7)**

166. In developing draft RTS regarding the details and type of reporting to TRs, ESMA considered the following key elements:

- a. the purpose and content of reporting;
- b. the elements to correctly identify the contracts and the corresponding counterparties; and
- c. the level of granularity.

167. In developing draft ITS on format and frequency, ESMA considered:

- a. what would the actual fields to be used to report each element; and
- b. standard codes for the identification of contracts, trades, counterparties/clients, etc..

168. ESMA preliminary view is that the fields indicated in the table attached to this report (Annex II) should be reported by counterparties to TRs in order to comply with Article 7. Some of these fields will require some guidance to ensure consistency among reporting entities. This is particularly relevant for the items highlighted in this Discussion Paper.

169. The table is divided in two sub-sets: (i) Table 1 - counterparty data (to be reported separately by each counterparty or their appointed reporting entity); and (ii) Table 2 - common data (that may be reported by only one counterparty, if reporting also on behalf of the other, or an appointed reporting entity).

170. The items below follows the sequence of the table as much as possible and the contents for technical standards as described in EMIR under this point notably:

- a. purpose of reporting;
- b. contents of reporting;
- c. format of reporting;

whereas on contents, the table is organised as follows with the format details embedded under each appropriate item:

- a. parties to the contract;
- b. contract type;
- c. details on the transaction;
- d. risk mitigation and clearing;
- e. specific derivatives classes.

171. EMIR already indicates a minimum set of information to be required and developed under the standards: the parties to the contract, beneficiaries and the main characteristics of the contract, notably type, underlying, maturity, notional value, price and settlement date.

172. On the purpose of reporting, ESMA has considered the G20 Pittsburgh declaration and the objectives of EMIR. Besides transparency, protection against market abuse and systemic risk mitigation, ESMA has also considered that TR data could be useful to ensure firms comply with other requirements in EMIR.

173. Also following the above mentioned objectives, a consistency check was made between EMIR and reporting to TRs, on the one hand, and the transaction reporting mechanisms already in place in the EU under MiFID, on the other hand. CESR had in the past advocated the synergies between existing transaction reporting mechanisms and TRs and the usage of TRs, if wished by counterparties, for simultaneous reporting under EMIR and MiFID. The draft MiFID proposal notes that TRs may seek authorisation as an ARM under MiFID, and if this authorisation is granted, then the reporting of a trade to the TR/ARM would ensure compliance with both EMIR and MiFID reporting requirements. The ability for a TR to qualify as an ARM will be assisted by the compatibility of the dataset required to be reported to TRs with that under MiFID transaction reporting requirements (and which is currently under review as part of the MiFID review process). Reporting under EMIR, as understood by ESMA when considering technical options for the drafting of technical standards, is more extensive in scope than the current MiFID reporting obligations.

**Q69: What is your view on the need to ensure consistency between different transaction reporting mechanisms and the best ways to address it, having in mind any specific items to be reported where particular challenges could be anticipated?**

174. Under EMIR, the reporting obligation is placed on both counterparties to a derivative contract (including CCPs), without prejudice to the fact that counterparties may delegate reporting to one of the two counterparties or to a third entity inside or outside the EU. Such delegation to a third party does not affect the liability of the individual counterparty under the duty to report nor the need for it to ensure any outsourcee or delegate follows all applicable requirements under EMIR and its implementing measures. The attached two-part table includes:

- a. Table 1: Counterparty data - which must be reported in relation to each counterparty for each derivatives transaction; and
- b. Table 2: Common data - that may be reported by the two counterparties separately or that may be reported only once and on behalf of both counterparties.

**Q70: Are the possible fields included in the attached table, under Parties to the Contract, sufficient to accurately identify counterparties for the purposes listed above? What other fields or formats could be considered?**

Beneficiaries

175. Where the economic beneficiary of a derivatives trade is not the counterparty, the beneficiary should be identified. While back-to-back trades would be reported separately, transparency of other trading techniques must be ensured, notably those including the use of structures where there may be morphing of beneficiaries. In practice identification of a specific beneficiary or beneficiaries may be complex, particularly where there is a chain of beneficiaries.

176. In the case of certain structures, such as funds, the identification of beneficiaries could prove difficult. It is useful to define beneficiary (e.g. an individual or entity in a financial contract as the recipient of the assets or proceeds of the contract) and most importantly the level of disclosure in the case of a chain of beneficiaries. The ultimate beneficiaries in the case of certain structures could be multiple and in turn, the reporting and supervision proves more complex. ESMA preliminarily considers that not identifying beneficiaries could incentivise the use of certain legal and business structures to morph economic beneficiaries. This would hamper transparency and investigation of market abuse and other wrongdoing.

**Q71: How should beneficiaries be identified for the purpose of reporting to a TR, notably in the case of long chains of beneficiaries?**

Coding

177. Under EMIR, ESMA is required to develop ITS specifying the formats that need to be used in the reporting of trade information to TRs, and ESMA is consequently considering the widest usage of coding as possible. These codes will serve a multitude of purposes, notably to favour consistency, uniqueness, reduce the costs of reporting and analysing information reported and will increase efficiency in the overall chain provided certain principles are followed in creating, generating and using the code.

178. Codes are being considered for counterparty identification but also for product identification and trade identification.

179. As regards counterparties, two sorts of codes may be considered, depending on the legal nature of the counterparty: if a legal person, a legal entity identifier (LEI<sup>4</sup>); if a natural person, an easily and widely available unique identifier. Currently under the MiFID transaction reporting system such identifier coincides with the client id assigned by the intermediary. Indeed such code is not ideal as it does not comply with the principle of universality, thus it will not allow for the identification of the same individual reported by two different intermediaries. Other solutions could, therefore, be considered in particular if widely available, at least in certain jurisdictions.

**Q72: What are the main challenges and possible solutions associated to counterparty codes? Do you consider that a better identifier than a client code could be used for the purpose of identifying individuals?**

180. ESMA's preliminary view is that the essential elements under this category that should be reported to a TR are:

- a. product taxonomy;
- b. product ID;
- c. underlying.

181. In order to appropriately identify and categorise derivative products, an organised taxonomy is essential, covering the range of derivatives products traded. This taxonomy should be designed as to clarify the array of products available in the derivatives markets as covered by EMIR. As mentioned above, coding is essential to ensure efficient reporting and may be derived from the available taxonomies. In extreme cases (e.g. bespoke products) codes may be difficult to be designed, although the taxonomies should be flexible enough to describe possible complex products.

182. Several industry initiatives have been launched on taxonomies and codes for derivatives products. As regards the taxonomy, ESMA will likely take subsidiary action, should the market not develop an adequate solution for TR reporting purposes.

183. As regards product codes in particular, ESMA is agnostic on the specific providers involved in the development of a unique product code (UPI). ESMA is following the market initiatives in this regard, as of other codes and defined very clear principles for coding that expects to see reflected in the results of such industry efforts at the worldwide level. This alignment would enable such codes to be accepted under the reporting to TRs and references to the codes could be included in implementing technical standards. Open access and global reach are two prime examples of these principles, which are being developed at the FSB level and are already supported by the G20 (as regards the LEI, to which they primarily apply) and CPSS and IOSCO in their *Report on OTC derivatives data reporting and aggregation requirements*.

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<sup>4</sup> To the extent that a global and recognised LEI will exist at the time of implementation of EMIR and enable counterparties to comply with EMIR and the technical standards.

184. In the particular case of baskets, challenges may be expected as regards its identification level and method, particularly in the case of baskets composed by underlying of different asset classes.

**Q73: What taxonomy and codes should be used for identifying derivatives products when reporting to TRs, particularly as regards commodities or other assets for which ISIN cannot be used? In which circumstances should baskets be flagged as such, or should their composition be identified as well and how? Is there any particular aspect to be considered as regards a possible UPI?**

#### Details on the transaction

##### *Trade Identification*

185. ESMA is considering that in order to effectively match counterparties to a trade, where those trades are reported separately by each counterparty (potentially to two different trade repositories), a trade ID should be reported with each counterparty to allow for the matching of each side of the transaction.

186. Such a code could be agreed bilaterally and assigned by counterparties, or generated by the trading platform. As noted, consistent and unique coding systems for these trade IDs are crucial to reduce reporting costs and to increase the efficiency of reporting and analysis by ensuring different TRs are able to accurately match transactions within their systems.

**Q74: How complex would be for counterparties to agree on a trade ID to be communicated to the TR for bilaterally executed transactions? If such a procedure is unfeasible, what would the best solution be to generate the trade ID?**

##### *Pricing and fees*

187. ESMA considers that three essential elements within the reporting obligation under EMIR that will be useful to authorities in understanding the price at which derivatives are traded are:

- a. price/rate/spread;
- b. price multiplier; and
- c. up-front payment.

188. These are already included in the attached table of fields. There are however other elements that could be taken into account, including on fee-related elements and other sub-sets of pricing.

189. ESMA considers that it may be of regulatory interest for authorities to understand the extent to which the trading price differs from market fair value as a result of fees being incorporated into a price by a broker when trading with a client. This would allow regulators to understand the market fair value of trades and the impact on fees of pricing for different derivatives products.

**Q75: Would information about fees incorporated into pricing of trades be feasible to extract, in your view?**

#### Risk mitigation and clearing

190. ESMA is considering a number of fields to be reported in order to facilitate the monitoring of market participants compliance with EMIR obligations, including on clearing procedures. These elements would be:

- a. a timestamp on the time of reporting to the TR;
- b. the type of platform where the trade was executed;
- c. whether confirmation has taken place on the transaction and, if so, whether it was by electronic means;
- d. whether the exposure of counterparties to the trade is collateralised;
- e. whether there is an obligation to clear, whether the trade was cleared and, if cleared, when the trade was novated for clearing and by which CCP;
- f. whether the trade qualifies as intra-group for the application of the exemption on intra-group trades.

**Q76: What is your view of the granularity level of the information to be requested under these fields and in particular the format as suggested in the attached table?**

Specific asset classes

191. Counterparties are expected to report the elements referred to above on counterparties, contracts and the trade, irrespective of the type of underlying. As regards specific classes of derivatives, there may be detailed fields that could be considered and only applicable to such class.

192. In addition to the elements referred in the table in Annex II, ESMA is considering specific fields for the following classes, as listed in the attached table (sections 2e to 2g):

- a. equity derivatives;
- b. interest rate derivatives;
- c. currency derivatives.

193. On commodity derivatives and credit derivatives ESMA is still considering whether any specific items should be added.

**Q77: Are the elements in the attached table appropriate in number and scope for each of these classes? Would there be any additional class-specific elements that should be considered, particularly as regards credit, equity and commodity derivatives? As regards format, comments are welcome on the possible codes listed in the table.**

Additional points

*Data on exposures*

194. Trade repositories should serve, within the G20 mandate and under EMIR, to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse. There are however limitations of trade repositories given their current design and the time needed to adapt to the reporting requirements that currently are considered as “data gaps”. Some of these have been listed in the *IOSCO-CPSS Report on OTC derivatives data reporting and aggregation requirements*.
195. In particular, exposures of a given counterparty at the bilateral portfolio level should be made possible in accurate terms. Because risk exposure varies according to a derivative’s market value, current exposures are the most feasible elements to assess counterparty risk. It should, however, be noted that under Article 6 financial counterparties and non-financial above the threshold have an obligation to mark-to-market their exposures on a daily basis. Therefore such information will need to be available within the counterparty.
196. It should also be noted that the assessment of counterparty risk would only be accurate if collateral (margins, for this purpose) are taken into account. To have the accurate valuation of collateral, this information would have to be updated on a regular basis.
197. TRs do not yet capture this data on exposures and collateral. Although it would be desirable to have this dataset available as soon as possible, in order to properly monitor concentration of exposures and systemic risk, ESMA understands the IT, operational and financial challenges involved. It may therefore consider a phased-in approach.

**Q78: Given that daily mark-to-market valuations are required to be calculated by counterparties under [Article 6/8] of EMIR, how complex would it be to report data on exposures and how could this be made possible, particularly in the case of bilateral trades, and in which implementation timeline? Would the same arguments also apply to the reporting of collateral?**

#### Reporting by third parties

198. Reporting to TRs may be undertaken by third parties, i.e. parties other than the two counterparties to a derivatives transaction. ESMA expects counterparties to carefully select such third parties to ensure the third parties are providing accurate and timely information to TRs, particularly due to the fact that such third entities may be outside the powers of a competent authority. Third parties need to guarantee protection of the data and compliance with the reporting obligation the same way the counterparty appointing them is required to. Given the importance of maintaining accurate data in TR, in extreme cases, ESMA may request the competent authority of a counterparty to take action in relation to the use of a third party reporting entity which is not able to ensure that counterparties duly comply with their reporting obligations under EMIR and/or do not enable TRs to perform their duties. In the most extreme cases (such as when third party is not fulfilling its obligations for multiple counterparties across Europe, or where the actions of the third party severely affect a TR) ESMA should be able to intervene. In particular, competent authorities should be able to require counterparties under their scope of action to stop using a certain reporting entity in case repeatedly incorrect or delayed data is provided by the third party to a TR after the third party was given a sufficient period of time in order to take remedial action. Along the same lines, ESMA should be able to prevent a TR under its supervision to accept reporting by third parties that may jeopardize the accuracy of the data held in the TR.

**Q79: Do you agree with this proposed approach? What are in your view the main challenges in third party reporting and the best ways to address them?**

## Application for Registration (Article 52)

199. In defining the elements to be contained in the application for registration of TRs, ESMA is considering:

a. ownership

Under this category, a chart could be considered and all associated entities to the TR, at worldwide level, could be indicated

b. organisational structure, governance and compliance

Possibly including roles, reporting lines, accountable persons

c. staffing and compensation

This might include specific details on remuneration, mitigation of over-reliance on individual employees, staff-sharing with other entities

d. financial resources

Detailed financial documentation could be required (annual reports, balance sheet, business plan), including the necessary and readily available financial resources to ensure smooth operations of the TR in all circumstances including an orderly winding down or restructuring of operations

e. conflicts of interest

Internal policies could be required on identification and mitigation

f. resources and procedures

Detailed information on IT systems, outsourcing arrangements

g. access and transparency

Details on compliance, particularly on accuracy of data, confidentiality and access rights, including a possible specification of the different categories of access of TR clients to the TR-held data.

h. operational reliability

Possible extensive details on business resources, processes, interdependencies, business continuity elements and testing.

i. recordkeeping

Possible procedures that the TR should have in order to ensure timely registration, data confidentiality, integrity, format/aggregation level and up datedness

j. data availability

Detailed information should be required in order to ensure that TRs will be complying with the duties to provide regular and aggregate information to the public, detailed information to the relevant counterparties and competent authorities, respecting the timeline and other requirements under EMIR.

**Q80: Do you envisage any issues in providing the information/documentation as outlined above? In particular:**

- a) what would the appropriate timeline over which ESMA should be requesting business plans (e.g. 1, 3, 5 years?)**
- b) what would the appropriate and prudent length of time for which a TR must have sufficient financial resources enabling it to cover its operating costs (e.g. 6 months / 1 year)?**

200. In defining the format of the application for registration of TRs, ESMA believes that an application for registration shall be provided in an instrument which:

- a. stores information in a way accessible for future reference; and
- b. which allows the unchanged reproduction of the information held.

201. Certainty is key for ESMA in the registration process. For this purpose, it could be envisaged that an applicant trade repository:

- a. assigns a unique reference number to each document it submits and ensure that the information submitted clearly identifies to which specific requirement of the standards it refers to, and in which document that information is provided;
- b. clearly indicates in the application, also providing for an explanation, where in its view a requirement of the standards does not apply;
- c. covers any documents sent to ESMA with a letter signed by a member of the trade repository's senior management, attesting that the submitted information is accurate and complete to the best of their knowledge, as of the date of that submission;
- d. accompanies any documents submitted to ESMA with the relevant corporate legal documentation showing the veracity of the data, notably decisions taken at board level.

**Q81: What is your view on these concerns and the ways proposed to address them? Would there be any other concerns to be addressed under the application for registration and tools that could be used?**

## **Transparency and data availability (Article 67)**

202. When considering technical standards defining the scope of the TR-held data to which authorities and the public will have access to, ESMA considered the following key elements:

- a. the granularity of data to be disclosed per type of recipient: (a) for the public; (b) for each relevant authority;
- b. how information should be disclosed and organised;
- c. the means to receive this information (e.g. direct access, website, other);
- d. the frequency of the disclosure to both the public and to the different authorities; and
- e. the level of aggregation to be considered in the public disclosure or depending of the receiving authority.

203. ESMA's approach as regards the output of trade repositories is to ensure accuracy of data, confidentiality in its transmission and recording where not public or under the competences of a certain authority and automation. ESMA also considers that where possible, information should be made available to authorities in an automated form, as ad-hoc requests will limit the ability of requestors' to obtain timely access to information while also being burdensome to trade repositories.

204. Filtering will be key and enable a swift and accurate processing of requests. Some preliminary work has already been conducted at the international level, notably by the ODRF. The ODRF guidelines on data access were, however, designed for a specific class of derivatives and a particular trade repository. The broader scope of EMIR is likely to require a somewhat different approach. CPSS and IOSCO have also recently been tasked by the FSB<sup>5</sup> and G20<sup>6</sup> to take forward work on authorities' access to TR data building on the work of the ODRF. ESMA will seek to incorporate any relevant outputs from this work into the RTS.

205. On data to be accessed by authorities efforts are being made to facilitate an ex-ante definition of the Article 67-listed authorities access scope. This access is to be tailored according to each of the relevant authorities receiving it in view of their specific competences as foreseen under EMIR. In some cases precision will have to be made on the range of entities captured, given the national limitations to the jurisdiction of some authorities. Also not all types of authorities have, under a same category, the same access level, due to their different competences (hence the term 'relevant'). ESMA is considering these different cases in order to correctly shape the access levels. This will facilitate access to data by the competent authorities, avoid confidentiality breaches and reassure TRs by providing additional certainty on the filters to be applied to the interface between TR-held data and the accessing authorities.

206. ESMA is consulting the authorities listed in Article 67, notably the ESRB and the members of the ESCB, in order to identify the level of details and type of aggregation required to fulfil their respective

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<sup>5</sup> [http://www.financialstabilityboard.org/publications/r\\_111011b.pdf](http://www.financialstabilityboard.org/publications/r_111011b.pdf)

<sup>6</sup> <http://www.g20.org/Documents2011/11/Cannes%20Declaration%204%20November%202011.pdf>

mandates. From the work already conducted, ESMA's preliminary view is that the authorities that supervise individual entities should have access to transaction level<sup>7</sup> information for the entities they supervise. In particular:

- a. ESMA, for all data held by ESMA-supervised trade repositories;
  - b. The Authority for the Cooperation of Energy Regulators (ACER), for all data regarding derivatives on energy as defined in REMIT<sup>8</sup>;
  - c. the competent authorities supervising undertakings subject to the reporting obligation (banks, investment firms, insurance undertakings, etc.) for each transaction reported by or on behalf of the supervised entities. ESMA considers that notwithstanding the objective of supervision (prudential or conduct of business) the relevant competent authorities should have access to the full list of details reported by or on behalf of the supervised entities;
  - d. the competent authorities supervising CCPs accessing the TR, as regards trades cleared by such CCPs and/or reported by such CCPs;
  - e. the competent authorities supervising the venues of execution of the reported contracts, as regards trades executed in such venues;
  - f. EU securities and markets authorities should have access to transaction level data for the entities they supervise and for contracts on underlying under their jurisdiction; and
  - g. the competent authorities with responsibility for carrying out regulatory functions in relation to takeovers under the Directive on Takeovers Bids (Directive 2004/25/EC); as regards trades in equity derivatives where the underlying is either admitted to trading on a regulated market in their jurisdiction, or has their registered office within their jurisdiction.
207. With reference to third country competent authorities meeting the conditions referred to in Article 67 of EMIR, ESMA's preliminary view is that the same logic as described above for European authorities should apply, in line with their respective mandate.
208. In relation to information to be made public by TRs, the general principle is that only aggregate-level (and not transaction or portfolio) data is being considered.

**Q82: What level of aggregation should be considered for data being disclosed to the public?**

**Q83: What should the frequency of public disclosure be (weekly? monthly?); and should it vary depending on the class of derivatives or liquidity impact concerns; if yes, how?**

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<sup>7</sup> Transaction level being understood in this context as the set of details indicated in the table in Annex II for each relevant transaction.

<sup>8</sup> i.e. derivatives relating to the production, trade, transportation or delivery of natural gas or electricity in the Union.

**Annex I**

<p><b>Classification of financial instruments</b></p>	<p><b>p1: Period since the last recollection on margins</b></p>	<p><b>P2: Period for implementing the default management strategy</b></p>	<p><b>P3: Period to cover counterparty risk during the delivery</b></p>	<p><b>Total</b></p>
<p><b>Financial Instruments Category I:</b> It should be considered a financial instrument of category I those ones fulfilling the following conditions:</p> <ol style="list-style-type: none"> <li>1) They are admitted for trading in relevant order books trading platforms of regulated markets or multilateral trading facilities located in a Member State of the EEA, or admitted for trading on an equivalent third country market, without the presence of a liquidity provider and have a diverse group of buyers and sellers;</li> <li>2) They have a frequent flow of trades during the trading session making possible to buy or sell a normal sized position of a clearing member according to the margin model framework outlined in [art. X of the Review of Models, Stress and Back Testing RTS]at any time at a desire price without materially impacting its price;</li> <li>3) Trading volume has demonstrated strong resilience during the relevant stress periods detailed in the CCP stress test framework outlined in [art. X of the Review of Models, Stress and Back Testing RTS];</li> <li>4) Only one relevant source of risk is significant and it presents a simple valuation structure;</li> <li>5) They are denominated in the currencies</li> </ol>			<p>To be added according the each delivery mechanism</p>	

<p>which the CCP clears its payments or in the currency of a State which the CCP is able to is freely and readily convertible through a deliverable FX transaction into the currency in which the CCP has the majority of its liabilities.</p>				
<p><b>Financial Instruments Category II:</b> It should be considered a financial instrument of category II those ones fulfilling conditions 2), 3) and 5) for the category I, or directly referred to instruments complying with the conditions for the category I, but may not fulfil the conditions 1) or 4), making necessary an eventual agreement with a liquidity provider or a thorough analysis of market conditions for the financial instrument to properly execute de default management strategy at a desire price without materially impacting its price.</p>			<p>To be added according the each delivery mechanism</p>	
<p><b>Financial Instruments Category III:</b> It should be considered a financial instrument of category III those ones not fulfilling conditions for financial instruments of category I and II.</p>			<p>To be added according the each delivery mechanism</p>	

## Annex II

### Trade Repositories table of fields

**Table 1 - Counterparty Data**

	CONTENT [RTS]	FORMAT [ITS]
<b>Parties to the contract</b>		
Reporting timestamp	Date and time of reporting.	ISO 8601 date format / UTC time format.
ID of C/P	The reporting counterparty shall be identified by an unique code or, in the case of individuals, by a client code.	Legal Entity Identifier (LEI), BIC or Client Code
ID of the other C/P	Unique identifier for the other counterparty of the transaction	Legal Entity Identifier (LEI), BIC or Client Code
Name of C/P	Corporate name of C/P i.e. name of financial C/P; non-financial C/P; or individual.	Free Text, 50 alpha-numerical digits. If in the LEI, no need for this field.
Domicile of C/P	Information on the registered office, consisting of street name, street number, postal code, city and country.	Free Text, 500 alpha-numerical digits. If in the LEI, no need for this field.
Corporate sector of C/P	Nature of the company activities / status (bank, insurance company, etc.).	Taxonomy (B=Bank, I=Insurance company, etc.), if not in the LEI database.
Financial or Non-Financial nature of C/P	Indicate if the C/P a financial or non-financial counterparty in accordance with Article 2 (6) and 2(7) of EMIR	F=Financial Counterparty / N = Non-Financial Counterparty
ID of broker of C/P	In case C/P uses a broker to execute the transaction, this broker shall be identified by an unique code.	Legal Entity Identifier (LEI) or BIC
ID of the reporting entity	ID of the reporting party or a third reporting party .	Legal Entity Identifier (LEI) or BIC
ID of the clearing member	e.g. in case of give-up.	Legal Entity Identifier (LEI) or BIC
Beneficiary	If the beneficiary of the contract is not a C/P to this contract it has to be identified by an unique code or, in case of individuals, by a client code.	Legal Entity Identifier (LEI), BIC or Client Code
Trading capacity	Identifies whether the transaction was executed on own account (on own behalf or behalf of a client) or for the account of, and on behalf of, a client.	P=Principal A=Agent
C/P side	Identifies whether the contract was a buy or a sell from the reporting C/P's perspective.	B=Buyer / S=Seller
Trade with non-EEA Counterparty	In case the C/P has entered into a trade with a non-EEA C/P who is not subject to the reporting obligation.	Y=Yes / N=No
Directly linked to commercial activity or treasury financing	For non-financial C/P; Information on whether the contract is objectively measurable as directly linked to the non-financial counterparty's commercial or treasury financing activity.	Y=Yes / N=No; changes over the lifetime of a contract need to be reported. In case the hedge is no longer

		justified, the report should be amended.
Clearing threshold	Information whether the contract is above the clearing threshold.	Y=above / N=below

**Table 2 - Common Data**

**Both counterparties will need to report this data however where one counterparty reports on behalf of the other counterparty, the data only needs to be reported once.**

	CONTENT [RTS]	FORMAT [ITS]
<b>Section 2a - Contract type</b>		
Taxonomy	The used taxonomy for describing the classification of the reported contract.	Taxonomy, to be defined either by the industry or ESMA
Product ID	The contract shall be identified by using an unequivocally product identifier if available.	UPI
Underlying	The underlying shall be identified by using an unequivocally identifier for this underlying. In case of baskets or indices an indication for this basket or index shall be used in case an unequivocal identifier for this product doesn't exist.	ISO 6166 International Securities Identifying Number (ISIN) / Legal Entity Identifier (LEI) / B= Basket / I=Index.
Indication of the currency of the notional; in FX derivatives the currency to be delivered.	ISO 4217 Currency Code.	ISO Currency Code.
<b>Section 2b - Details on the transaction</b>		
Trade ID	Unique identifier for a trade as assigned by the two C/Ps or by the trading platform of execution.	likely up to 20 numerical digit.
Venue of execution / OTC	The venue of execution shall be identified by an unequivocal code for this venue. If the contract is executed outside an identified venue, it should refer to as OTC	ISO 10383 Market Identifier Code (MIC) or XXXX (OTC).
Type of venue of execution	To identify the type of venue	RM=Regulated Market; MTF= Multilateral Trading Facility; OTF=Organised Trading Facility; SI=Systemic Internaliser XXXX=OTC
Price / rate / spread	The price per derivative excluding, where applicable, commission and accrued interest.	Format (C=Cash, P=Percentage, Spread=S) and amount

		(xxxx,yy).
Notional amount	Face value of the transaction, i.e. value of the deliverables.	up to 10 numerical digits (xxxx,yy).
Price multiplier	The number of derivatives represented by one contract.	up to 10 numerical digits.
Quantity	Number of contracts included in the transaction.	up to 10 numerical digits.
Up-front payment	Amount of any up-front payment.	numerical digits in the format xxxx,yy.
Delivery type	Identifies whether the contract is settled physically or in cash.	C=Cash / P=Physical / O=Option Available to C/P.
Execution timestamp	The time and date a contract was executed or modified, indicating timezone, expressed as Coordinated Universal Time (UTC).	ISO 8601 date format / UTC time format.
Effective date	Date when obligations under the contract come into effect.	ISO 8601 date format.
Maturity date	Date when contract expires / exercise date.	ISO 8601 date format.
Termination date	TBD, if different from maturity	ISO 8601 date format.
Settlement date	Date of settlement of the underlying.	ISO 8601 date format.
Master Agreement type	In the interest of legal standardisation, reference to any master agreement, if existent (e.g. ISDA Master Agreement; Master Power Purchase and Sale Agreement; International ForEx Master Agreement; European Master Agreement, ...).	
Master Agreement date	Reference to the date of the master agreement version, if any (e.g. 1992, 2002, ...).	ISO 8601 date format.
<b>Section 2c - Risk mitigation / Reporting</b>		
Confirmation	Indicates whether the transaction was electronically confirmed, non-electronically confirmed or remains unconfirmed.	Y=Non-electronically confirmed / N=Non-confirmed / E=Electronically confirmed.
Confirmation timestamp	Date and time of the confirmation.	ISO 8601 date format / UTC time format.
Collateralisation	Indicates whether exchange of collateral occurred to cover the transaction.	Y=Yes / N=No.
<b>Section 2d - Clearing</b>		
Clearing obligation	Indicates whether the reported contract is to be mandatorily cleared.	Y=Yes / N=No.
Cleared	Indicates whether clearing took place.	Y=Yes / N=No.
Clearing timestamp	Time and date clearing took place.	ISO 8601 date format / UTC time format.
CCP	In case of a bilateral transaction that becomes novated after reporting the original transaction shall be kept and the indication whether it has been cleared reported in this field by using a unique code for the CCP that has cleared the contract.	Legal Entity Identifier code (LEI) or BIC of the CCP clearing the contract.
Intragroup	Indicates whether the contract was concluded as an intra-group transaction, defined in Art. 2a of Regu-	Y=Yes / N=No.

	lation [EMIR].	
<b>Section 2e - Equity Derivatives</b>		
TBD		
<b>Section 2f - Interest Rates</b>	<b>If a UPI is reported and contains all the information below, this is not required to be reported</b>	
Direction	Indicates whether the reporting counterparty is receiving or paying the fixed rate. In case of float-to-float or fixed-to-fixed contracts this field has to be filled as unspecified.	P=Payer of fixed rate, R=Receiver of fixed rate, U=Unspecified, For derivatives in general-if the principal is paying or receiving the fixed rate. For float-to-float and fixed-to-fixed, it is unspecified. For non-swap or swaptions, the instrument that was bought or sold.
Fixed rate	Indicates the level of the fixed rate leg.	numerical digits in the format xxxx,yy.
Fixed rate day count fraction	The actual number of days in the relevant Fixed Rate Payer Calculation Period in respect of which payment is being made divided by 360.	numerical digits in the format xxx/360.
Fixed leg payment frequency	Indicates the frequency of payments for the fixed rate leg.	D=daily, W=weekly, M=monthly, Q=quarterly, S=semi-annually, A=annually.
Floating rate payment frequency	Indicates the frequency of payments for the floating rate leg.	D=daily, W=weekly, M=monthly, Q=quarterly, S=semi-annually, A=annually.
Floating rate reset frequency	Indicates the frequency of floating rate leg resets.	D=daily, W=weekly, M=monthly, Q=quarterly, S=semi-annually, A=annually.
Floating rate to floating rate	Floating to floating rate.	
Fixed rate to fixed rate	Fixed to fixed rate.	
<b>Section 2g - Currency / Forex</b>	<b>If a UPI is reported and contains all the information below, this is not required to be reported</b>	
Currency 2	The cross currency, as different from the currency of delivery.	ISO 4217 Currency Code.
Exchange rate 1	At the moment of trade/agreement.	
Exchange rate 2	At the moment of trade/agreement.	
<b>Section 2h - Commodities</b>		

<b>Section 2i - Credit</b>		
<b>Section 2j - Options</b>	<b>If a UPI is reported and contains all the information below, this is not required to be reported</b>	
Option type	Indicates whether the contract is a call or a put from the reporting counterparty's perspective.	P=Put / C=Call.
Option style (exercise)	Indicates whether the option may be exercised only at a fixed date (European, Bermudan and Asian style) or at any time during the life of the contract (American style).	A=American, B=Bermudan, E=European, S=Asian.
Strike price (cap/floor rate)	The strike price of the option.	numerical digits in the format xxxx,yy.
<b>Section 2k - Modifications to the contract</b>		
Log	In order to build a trail of amendments and entities reporting those, the date and the relevant information on the amendment, to allow the TR to register the amendment to a previously registered trade while keeping a log of changes per date.	Free Text, the RTS will need to specify that when any of the above information related to a single transaction changes, the counterparties and the CCP should make sure that those changes are reported and a log of the changes kept.
<b>Other</b>	<b>Open field</b>	
<b>Exposures</b>	<b>TBD</b>	

## Annex III

### Summary of questions

- Q1:** In your views, how should ESMA specify contracts that are considered to have a direct, substantial and foreseeable effect within the EU?
- Q2:** In your views, how should ESMA specify cases where it is necessary or appropriate to prevent the evasion of any provision of EMIR for contracts entered into between counterparties located in a third country?
- Q3:** In your views, what should be the characteristics of these indirect contractual arrangements?
- Q4:** What are your views on the required information? Do you have specific recommendations of specific information useful for any of the criteria? Would you recommend considering other information?
- Q5:** For a reasonable assessment by ESMA on the basis of the information provided in the notification, what period of time should historical data cover?
- Q6:** What are your views on the review process following a negative assessment?
- Q7:** What are your views regarding the specifications for assessing standardisation, volume and liquidity, availability of pricing information?
- Q8:** What are your views, regarding the details to be included in ESMA Register of classes of derivatives subject to the clearing obligation (Article 4b)?
- Q9:** Do you consider that the data above sufficiently identify a class of derivatives subject to the clearing obligation and the CCPs authorised or recognised to clear the classes of derivatives subject to the clearing obligation?
- Q10:** In your view, does the above definition appropriately capture the derivative contracts that are objectively measurable as reducing risk directly related to the commercial or treasury financing activity?
- Q11:** In your views, do the above considerations allow an appropriate setting of the clearing threshold or should other criteria be considered? In particular, do you agree that the broad definition of the activity directly reducing commercial risks or treasury financing activity balances a clearing threshold set at a low level?
- Q12:** What are your views regarding the timing for the confirmation and the differentiating criteria? Is a transaction that is electronically executed, electronically processed or electronically confirmed generally able to be confirmed more quickly than one that is not?

- Q13:** What period of time should we consider for reporting unconfirmed OTC derivatives to the competent authorities?
- Q14:** In your views, is the definition of market conditions preventing marking-to market complete? How should European accounting rules be used for this purpose?
- Q15:** Do you think additional criteria for marking-to-model should be added?
- Q16:** What are your views regarding the frequency of the reconciliation? What should be the size of the portfolio for each reconciliation frequency?
- Q17:** What are your views regarding the threshold to mandate portfolio compression and the frequency for performing portfolio compression?
- Q18:** What are your views regarding the procedure counterparties shall have in place for resolving disputes?
- Q19:** Do you consider that legal settlement, third party arbitration and/or a market polling mechanism are sufficient to manage disputes?
- Q20:** What are your views regarding the thresholds to report a dispute to the competent authority?
- Q21:** In your views, what are the details of the intragroup transactions that should be included in the notifications to the competent authority?
- Q22:** In your views what details of the intragroup transactions should be included in the information to be publicly disclosed by counterparty of exempted intragroup transactions?
- Q23:** What are your views on the notion of liquidity fragmentation?
- Q24:** What are your views on the possible requirements that CCP governance arrangements should specify? In particular, what is your view on the need to clearly name a chief risk officer, a chief technology officer and a chief compliance officer?
- Q25:** Are potential conflicts of interests inherent to the organisation of CCPs appropriately addressed?
- Q26:** Do the reporting lines – as required – appropriately complement the organisation of the CCP so as to promote its sound and prudent management?
- Q27:** Do the criteria to be applied in the CCP remuneration policy promote sound and prudent risk management? Which additional criteria should be applied, in particular for risk managers, senior management and board members?
- Q28:** What are your views on the possible organisational requirements described above? What are the potential costs involved for implementing such requirements?

- Q29:** Should a principle of full disclosure to the public of all information necessary to be able to understand whether and how the CCP meets its legal obligations be included in the RTS? If yes, which should be the exceptions of such disclosure requirements? Has the information CCP should disclose to clearing members been appropriately identified? Should clients, when known by the CCP, receive the same level of information?
- Q30:** What are your views on the possible records CCPs might be required to maintain?
- Q31:** What are your view on the modality for maintaining and making available the above records? How does the modality of maintaining and making available the records impact the costs of record keeping?
- Q32:** What are your views on the possible requirements for the business continuity and disaster recovery plan and in particular on the requirements for the secondary site? Would it be appropriate to mandate the establishment of a third processing site, at least when the conditions described above apply? What are the potential costs and time necessary for the establishment of a third processing site and for immediate access to a secondary business site?
- Q33:** Is the 2 hours maximum recovery time for critical functions a proportionate requirement? What are the potential costs associated with that requirement?
- Q34:** Are the criteria outlined above appropriate to ensure that the adequate percentage above 99 per cent is applied in CCP's margin models? Should a criteria based approach be complemented by an approach based on fixed percentages? If so, which percentages should be mandated and for which instruments?
- Q35:** Taking into account both the avoidance of procyclicality effects and the need to ensure a balance distribution of the financial resources at the CCP disposal, what it is in your view the preferred option for the calculation of the lookback period.
- Q36:** Is in your view the approach described above for the calculation of the liquidation period the appropriate one? Should a table with the exact number of days be included in the technical standards? Should other criteria for determining the liquidation period be considered?
- Q37:** Is procyclicality duly taken into account in the definition of the margin requirements?
- Q39:** Do you believe that the elements outlined above would rightly outline the framework for managing CCPs' liquidity risk?
- Q40:** Do you consider that the liquid financial resources have been rightly identified? Should ESMA consider other type of assets, such as time deposits or money market funds? If so, please provide evidences of their liquidity and minimum market and credit risk.
- Q41:** Should the CCP maintain a minimum amount of liquid assets in cash? If so, how this minimum should be calculated?

- Q42:** What is your preferred option for the determination of the quantum of dedicated own resources of CCPs in the default waterfall? What is the appropriate percentage for the chosen option? Should in option a, the margins or the default fund have a different weight, if so how? Should different criteria or a combination of the above criteria be considered?
- Q43:** What should be the appropriate frequency of calculation and adaptation of the skin in the game?
- Q44:** Do you consider that financial instruments which are highly liquid have been rightly identified? Should ESMA consider other elements in defining highly liquid collateral in respect of cash or financial instruments? Do you consider that the bank guarantees or gold which is highly liquid has been rightly identified? Should ESMA consider other elements in defining highly liquid collateral in respect of bank guarantees or gold?
- Q45:** In respect of the proposed criteria regarding a CCP not accepting as collateral financial instruments issued by the clearing member seeking to lodge those financial instruments, is it appropriate to accept covered bonds as collateral issued by the clearing member?
- Q46:** Do you consider that the proposed criteria regarding the currency of cash, financial instruments or bank guarantees accepted by a CCP have been rightly identified in the context of defining highly liquid collateral? Should ESMA consider other elements in defining the currency of cash, financial instruments or bank guarantees accepted by a CCP as collateral? Please justify your answer.
- Q47:** Do you consider that the elements outlined above would rightly outline the framework for determining haircuts? Should ESMA consider other elements?
- Q48:** Do you believe that the elements outlined above would rightly outline the framework for assessing the adequacy of its haircuts? Should ESMA consider other elements?
- Q49:** Do you consider that the elements outlined above would rightly outline the framework for determining concentration limits? Should ESMA consider other elements?
- Q50:** Should a CCP require that a minimum percentage of collateral received from a clearing member is provided in the form of cash? If yes, what factors should ESMA take into account in defining that minimum percentage? What would be the potential costs of that requirement?
- Q51:** Do you consider that financial instruments and cash equivalent financial instruments which are highly liquid with minimal market and credit risk have been rightly identified? Should ESMA consider other elements in defining highly liquid financial instruments with minimal market and credit risk? What should be the timeframe for the maximum average duration of debt instrument investments?
- Q52:** Do you think there should be limits on the amount of cash placed on an unsecured basis?

- Q53:** Do you consider that CCP should be allowed to invest in derivatives for hedging purposes? If so, under which conditions and limitations.
- Q54:** Do you consider that the proposed criteria regarding the currency of financial instruments in which a CCP invests has been rightly identified in the context of defining highly liquid financial instruments with minimal market and credit risk? Should ESMA consider other elements in defining the currency of highly liquid financial instruments with minimal market and credit risk? Please justify your answer.
- Q55:** Do you consider that the elements outlined above would rightly outline the framework for determining the highly secured arrangements in respect of which financial instruments lodged by clearing members should be deposited? Should ESMA consider other elements? Please justify your answer.
- Q56:** Do you consider that the elements outlined above would rightly outline the appropriate framework for determining concentration limits? Should ESMA consider other elements? Please justify your answer.
- Q57:** What are your views on the definitions of back and stress testing?
- Q58:** What are your views on the possible requirements for a CCP's validation process?
- Q59:** What are your views on the possible back testing requirements?
- Q60:** Would it be appropriate to mandate the disclosure of back testing results and analysis to clients if they request to see such information?
- Q61:** Should the time horizons for back tests specified under 144(e) be more granular? If so, what should the minimum time horizon be? Should this be different for different classes of financial instruments?
- Q62:** What are your views on the possible stress testing requirements?
- Q63:** Would it be appropriate to mandate the disclosure of stress testing results and analysis to clients if they request to see such information?
- Q64:** What are your views on the possible requirements for reverse stress tests? And what impact do you think such requirements would have on industry?
- Q65:** Should there be any other parties involved in the definition and review of tests? Please justify your answer and explain the extent to which suggested parties should be involved?
- Q66:** Should the testing of default procedures involve a simulation process?
- Q67:** Are the frequencies specified above appropriate? If no, please justify your answer.
- Q68:** In your view what key information regarding CCP risk management models and assumptions adopted to perform stress tests should be publicly disclosed?
- Q69:** What is your view on the need to ensure consistency between different transaction reporting mechanisms and the best ways to address it, having in mind any specific items to be reported where particular challenges could be anticipated?

- Q70:** Are the possible fields included in the attached table, under Parties to the Contract, sufficient to accurately identify counterparties for the purposes listed above? What other fields or formats could be considered?
- Q71:** How should beneficiaries be identified for the purpose of reporting to a TR, notably in the case of long chains of beneficiaries?
- Q72:** What are the main challenges and possible solutions associated to counterparty codes? Do you consider that a better identifier than a client code could be used for the purpose of identifying individuals?
- Q73:** What taxonomy and codes should be used for identifying derivatives products when reporting to TRs, particularly as regards commodities or other assets for which ISIN cannot be used? In which circumstances should baskets be flagged as such, or should their composition be identified as well and how? Is there any particular aspect to be considered as regards a possible UPI?
- Q74:** How complex would be for counterparties to agree on a trade ID to be communicated to the TR for bilaterally executed transactions? If such a procedure is unfeasible, what would the best solution be to generate the trade ID?
- Q75:** Would information about fees incorporated into pricing of trades be feasible to extract, in your view?
- Q76:** What is your view of the granularity level of the information to be requested under these fields and in particular the format as suggested in the attached table?
- Q77:** Are the elements in the attached table appropriate in number and scope for each of these classes? Would there be any additional class-specific elements that should be considered, particularly as regards credit, equity and commodity derivatives? As regards format, comments are welcome on the possible codes listed in the table.
- Q78:** Given that daily mark-to-market valuations are required to be calculated by counterparties under [Article 6/8] of EMIR, how complex would it be to report data on exposures and how could this be made possible, particularly in the case of bilateral trades, and in which implementation timeline? Would the same arguments also apply to the reporting of collateral?
- Q79:** Do you agree with this proposed approach? What are in your view the main challenges in third party reporting and the best ways to address them?
- Q80:** Do you envisage any issues in providing the information/documentation as outlined above? In particular:
- a) what would the appropriate timeline over which ESMA should be requesting business plans (e.g. 1, 3, 5 years?)
  - b) what would the appropriate and prudent length of time for which a TR must have sufficient financial resources enabling it to cover its operating costs (e.g. 6 months / 1 year)?

**Q81: What is your view on these concerns and the ways proposed to address them? Would there be any other concerns to be addressed under the application for registration and tools that could be used?**

**Q82: What level of aggregation should be considered for data being disclosed to the public?**

**Q83: What should the frequency of public disclosure be (weekly? monthly?); and should it vary depending on the class of derivatives or liquidity impact concerns; if yes, how?**



## **Annex IV**

### **Legislative mandate to develop draft technical standards**

#### Article 3

ESMA shall develop draft regulatory technical standards specifying the contracts that are considered to have a direct, substantial and foreseeable effect within the EU or the cases where it is necessary or appropriate to prevent the evasion of any provision of this Regulation.

ESMA shall develop draft regulatory technical standards specifying the types of indirect contractual arrangements that meet the conditions referred to in paragraph 2, second subparagraph.

#### Article 4

ESMA shall develop draft regulatory technical standards specifying the following:

- (a) the details to be included in the notification referred to in paragraph 1;
- (b) the criteria referred to in paragraph 3;

#### Article 4b

ESMA may develop draft regulatory technical standards to specify the details to be included in the public register referred to in paragraph 1.

#### Article 6/7

ESMA shall develop draft regulatory technical standards specifying the details and type of the reports referred to in paragraphs 1 and 2 for the different classes of derivatives.

The reports referred to in paragraph 1 and 2 shall contain at least:

- a) the parties to the contract and, where different, the beneficiary of the rights and obligation arising from it
- b) the main characteristics of the contracts including the type, underlying maturity, notional value, price, and settlement date

ESMA shall develop draft implementing technical standards determining:

- a) the format and frequency of the reports referred to in paragraphs 1 and 2 for the different classes of derivatives,
- b) the date by which derivatives contracts shall be reported, including any phase in for contracts entered into before the reporting obligation applies.

#### Article 5/7



Powers are delegated to the Commission to adopt regulatory technical standards in accordance with Article 15 of Regulation (EU) No 1095/2010 (ESMA Regulation) setting:

- a) criteria for establishing which OTC derivative contracts are objectively measurable as reducing risks directly related to the commercial activity or treasury financing activity referred to in paragraph (3), and
- b) values of the clearing thresholds. The value of those thresholds shall be determined taking into account the systemic relevance of the sum of net positions and exposures by counterparty and per class of OTC derivatives.

#### Article 6/8

ESMA shall draft regulatory technical standards specifying:

- a) the procedures and arrangements referred to in para 1 (timely confirmation, portfolio reconciliation, etc.),
- b) the market conditions that prevent marking-to-market referred to in para 1a and the criteria for using marking to model referred to in para 1a.
- c) the details of the exempted intragroup transactions to be included in the notification referred to in paragraphs 1cc, 1cccc and 1ccccc (Notification to competent authorities);
- d) the details of the information on exempted intragroup transactions referred to in paragraph 1d (public disclosure).

#### Article 8a

ESMA shall develop drafts regulatory technical standards specifying the concept of liquidity fragmentation.

#### Article 23

Powers are delegated to the Commission to adopt regulatory technical standards specifying the information that the applicant CCP shall provide ESMA in its application for recognition.

The regulatory technical standards referred to in the first subparagraph shall be adopted in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010 (ESMA Regulation).

#### Article 24

ESMA, in consultation with the members of the ESCB, shall develop draft regulatory technical standards specifying the minimum content of the rules and governance arrangements referred to in paragraphs (1) to (8):

- organisational structure, lines of responsibility, internal control mechanisms and administrative and accounting procedures;
- effective policies and procedures to ensure compliance with the Regulation;

- separation between reporting lines for risk management and other CCP operations;
- remuneration policy promoting sound and effective risk management;
- information technology to ensure security, integrity and confidentiality of information maintained by the CCP;
- disclosure of governance arrangements and governing rules and admission criteria; and
- independent audits of the CCPs.

#### Article 27

ESMA shall develop draft regulatory technical standards specifying the details of the records and information to be retained as referred to in paragraphs 1 to 3.

ESMA shall develop draft implementing technical standards to determine the format of the records and information to be retained.

#### Article 32

ESMA shall, in consultation with the members of the ESCB, develop draft regulatory technical standards specifying the minimum content and requirements of the business continuity policy and of the disaster recovery plan

#### Article 39

ESMA shall, after consulting EBA and the ESCB, develop draft regulatory technical standards specifying the appropriate percentage and time horizons for the liquidation period and the calculation of historical volatility, as referred to in paragraph 1, to be considered for the different classes of financial instruments taking into account the objective to limit procyclicality and the conditions under which portfolio margining practices referred to in paragraph 3a can be implemented.

#### Article 40

ESMA shall, in close cooperation with the ESCB and after consulting EBA, develop draft regulatory technical standards specifying the framework for defining extreme but plausible market conditions referred to in paragraph (2a), that should be used when defining the size of the default fund and the resources referred to in Article 41 paragraph 2.

#### Article 41a

Powers are delegated to the Commission to adopt regulatory technical standards specifying the framework for managing the CCP's liquidity risk referred to in paragraph 21 that the CCP shall withstand.

The regulatory technical standards referred to in the first subparagraph shall be adopted in accordance with Articles 10 to 14 of Regulation (EU) No1095/2010 (ESMA Regulation).



#### Article 42

Powers are delegated to the Commission to adopt regulatory technical standards specifying the methodology for calculation and maintenance of the amount of the CCP's own resources to be used in accordance with paragraph 3a.

The regulatory standards referred to in the first subparagraph shall be adopted in accordance with Articles 10 to 14 of Regulation EU 1095/2010 [ESMA Regulation].

#### Article 43

ESMA shall, after consulting, EBA and the ECB develop draft regulatory technical standards specifying the type of collateral that could be considered highly liquid, such as cash, gold, government and high-quality corporate bonds, covered bonds, and the haircuts and the conditions under which commercial bank guarantees may be accepted as collateral referred to in paragraph 1

#### Article 44

ESMA shall, after consulting, EBA, develop draft regulatory technical standards specifying the financial instruments that can be considered highly liquid, bearing minimal credit and market risk as referred to in paragraph 1, the highly secured arrangements referred to in paragraph 2b and 3.0 and the concentration limits referred to in paragraph 4.

#### Article 46

ESMA shall develop draft regulatory technical standards specifying the following:

- (a) the type of tests to be undertaken for different classes of financial instruments and portfolios;
- (b) the involvement of clearing members or other parties in the tests;
- (c) the frequency of the tests;
- (d) the time horizons of the tests;
- (e) the key information to be publicly disclosed on the risk management model and assumptions adopted to perform the stress tests.

#### Article 52

ESMA shall develop draft regulatory technical standards specifying the details of the application for registration to ESMA.

ESMA shall develop draft implementing technical standards determining the format of the application for registration to ESMA.

#### Article 67

ESMA shall develop draft regulatory technical standards specifying the frequency and the details of the information referred to in paragraphs 1 (public disclosure) and 2 (disclosure to relevant authorities) as well as operational standards required in order to aggregate and compare data across repositories and for



the entities referred to in paragraph 2 to have access to information as necessary. Those draft regulatory technical standards shall aim to ensure that the information published under paragraph 1 is not capable of identifying a party to any contract.