

**Wholesale Markets Brokers' Association and London Energy Brokers' Association  
Response to ESMA Draft Technical Standards for the Regulation on OTC Derivatives,  
CCPs and Trade Repositories**

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**Response to ESMA Draft Technical Standards for the Regulation on OTC  
Derivatives, CCPs and Trade Repositories**

- Collateral treatment of Organised Trading Venues:
- Access
- Eligibility for Mandated Clearing
- Transaction Reporting to Repositories

Monday 06 August 2012

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### 1. Introduction

The members of the WMBA welcome this opportunity to engage with ESMA on these regulatory technical standards and would emphasise the great deal of work that has been done by the wholesale brokering community to seamlessly and efficiently transmit and report completed trades into the post trade financial market infrastructures (FMIs) via electronic STP. This reflects the changed nature of our members business from purely acting as agents and arrangers towards also fulfilling the obligations of organised venues and the concomitant responsibility that falls to the venues for confirmation, affirmation and for ensuring the completion of legal novation.

The WMBA notes that despite its members arranging the vast majority of traded volumes globally, collectively in excess of 3 Trillion USD notional each and every day, it should only comment on the specific questions raised by ESMA in relation to a level playing field across venues, Access to FMIs and to the methodology whereby products become deemed eligible for mandatory clearing. In addition there are a number of general fundamental issues in respect of transaction reporting that remain unresolved. Important here is an ongoing request by legislators for venues to enforce any position limits and management that may be deemed necessary. It remains self-evident that this is the exact responsibility of trade repositories whereas venues can only report the flows transacted and the identity of the executing counterparties. Venues are unable to report the static risk profiles of the underlying legal beneficial owners standing behind the trade.

### 2. General Remarks

#### In respect of Collateral treatment of Organised Trading Venues:

- The WMBA remains concerned at a possible prejudice within the ESMA RTS proposals between Regulated Markets (“Exchanges”) and other Organised Venues (“MTFs and OTFs”) in respect of the margin calculation procedure proposed for *OTC derivatives* as compared to *financial instruments other than OTC derivatives*. Given that the definition of OTC derivative in EMIR Level 1 is a derivative that is not traded on a Regulated Market (see *EMIR Article 2(7): an OTC derivative contract is “a derivative contract the execution of which does not place on a regulated market as within the meaning of Article 4(1)(14) of Directive 2004/39/EC*); it may be deduced that out of the population of derivatives traded which are likely to be caught under the clearing mandate, those classed as OTC derivatives may be those traded on either an MTF or an OTF, but not those traded on an RM.
  - *“In particular, the characteristics of OTC products seem to require a confidence level interval higher than 99%. Indeed, the OTC derivatives segment is characterised by specific risk characteristics, e.g. potentially limited liquidity, the difficulty to obtain prices, the absence of a regulated market to liquidate positions, a restricted number of participants with potentially high concentrations. “*
  - *“For less liquid products, such as OTC derivatives, the period for the management of the exposures of a CCP should be, at a minimum, equal to 5 business days. For other financial instruments, the period for the management of exposures of a CCP should be, at a minimum, 2 business days. “*

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In effect, ESMA would appear to be saying that they want to make it far more expensive for a market participant to trade and carry a product which was executed on an OTF or an MTF than for that same product to have been traded on an RM. This would appear not only to be illogical, since designated contracts suffer far more brittle liquidity in smaller size, but it is also away from the relevant IOSCO principals. Indeed ESMA would seem to making the grave error in supposing that liquidity is either greater or deeper on an RM than in the other two venues. Indeed we would contend that the reality is patently the reverse for amounts other than those pertaining to strictly retail size. For example, recent issues with MF Global and Knight Capital underline that this forms an illogical starting point.

It would therefore follow to be vital that ESMA both:

- clarify the more onerous margin requirements to apply to those products traded outside ANY organised venue (RM, MTF, OTF).
- allow a CCP to make margining decisions above a commonly accepted minimum such as 99% and 2 days according to their own risk modelling and governance.

### **In respect of Access:**

- In operating the venues for the majority of relevant executions in the scope of this DP, the WMBA have a close interest in the access provisions afforded to venues for open and fair access to CCPs. This is particularly important in the context that most CCPs will also be operating trade venues in direct competition from within the vertical silo. Given the sensitivity of the boundary between utility and commercial enterprise for these mandated and systemic institutions, we are rather disappointed that ESMA have not discussed this topic in the Discussion Paper.
- As venues for derivative trading, the organised trading venue, as either an OTF or an MTF, requires and relies upon the certainty of non-discriminatory access to clearing. The WMBA fully supports and welcomes the enhanced requirements that MiFIR will hopefully detail over and above those within EMIR, but initially under these RTS we request that ESMA sets out a level playing field for all venues to produce the concomitant benefits of competition and continuous peer review for all end users.
- The WMBA understands the need for prudential management by CCPs but fundamentally disagrees with the premise that a vertically integrated CCP operating as a privately held entity in a "for profit" capacity should be able to act as discretionary gatekeeper to third party trading venues. Instead, the authorisation of an organised trading venue as either an OTF or an MTF should incorporate the authorisation of that venue to freely and fairly submit venue executed transactions to any CCP of the counterparties' choice which is authorised to clear that category of derivative using the European passport provisions as entry to such facilities.
- Additionally, through the experience of managing our trading systems, WMBA members recognise that barriers to entry to the submission of trades to a CCP may not only be via acceptance of the actual trade but also via many other factors including but not limited to: (a)

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the cost of clearing offered to a particular participant; (b) the speed of response to inquiries relating to technical matters including infrastructure, messaging, connectivity, and access to APIs; (c) the hidden bundling of costs within the vertical CCP silo; (d) the slower acceptance for clearing of trades executed at third party venues than those executed at the vertical silo venue; (e) varying speeds of affirmation and novation messaging by participant type; and (f) curtailed access to third party venues of the credit and collateral status of clearing members.

- Rather than being subject to the potentially capricious use of the three month review and response periods the WMBA would therefore recommend that the clearing eligibility of a product should not come into force under ESMA until a sufficient number of organised applicant venues such that customer choice is preserved, have been granted equal and satisfactory access into the requested CCPs, and that the period of the consideration of which products should be centrally cleared should run concurrently with the review of the OTF access applications.
- The WMBA does not foresee any problems or difficulties with the proposed terms of access by the CCP to venues of execution. Furthermore we see the issues raised around the notion of liquidity fragmentation to be misleading and intended to obfuscate. These arguments tend to stem from issues surrounding the ownership of intellectual property rights and liquidity pools. Rather we see the competent use of technology and identifiers to enable a competitive environment in both venues and post trade FMI to develop which would only benefit end users via increased choice and innovation. Consequently we would strongly encourage ESMA to define only a very narrow definition of liquidity fragmentation if any at all.
- Trading venues will require real time access to the credit status of clearing members of a CCP in order to advertise and arrange trading orders submitted by these counterparties or on their behalf. Evidently if a CCP member has missed a variation margin payment and the CCP is less likely to accept trades for novation the venues need to be aware of this situation in the same manner that the CCP would inform its vertically integrated operations. We therefore ask ESMA to consider developing a technical standard to require CCPs to inform all connected venues of the credit status of clearing members in real time.
- The WMBA appreciates heightened operational risks implied by a larger set of relationships between CCPs and venues, but considers the benefits from competition, innovation and substitution that come with these as vastly greater. Concerns around the risk of a race to the bottom on risk management where CCPs compete for business again would pre-suppose that CCP members and their clients are agnostic to their own risk. We do not think this is the case, conversely prudent management is widely seen as a definite attraction as evidenced by the negative sovereign yields now witnessed in several countries. Indeed the implied spread pricing between different venues may be seen as the market actually helping supervisors carry out their responsibilities.
- The WMBA would concur with comments in the DP that the clearing obligation could break up some netting sets to the extent that, within current netting sets, some contracts have to be cleared and others do not. This would seem to be one area where liquidity would be compromised and systemic risk increased for what would appear to be purely political

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objectives. We would remind ESMA that in our view nearly all trades in derivatives are contingent upon the underlying or related contracts, and therefore the artificial breaking of netted sets could only have a detrimental impact upon liquidity and the cost of risk mitigation by end users.

- The WMBA remains highly concerned that in seeking CCP clearing as a complete panacea in the process of re-regulation post 2008 G20 accord, commercial objectives and empire building have obscured the efficiency in building utilities for collectively managing derivative risk and trade repositories for systemic analysis and reporting. This is evidently manifest in the tendency for the construction of vertical silo's and fettered access. This may be more acute in the initial process around the introduction of mandated clearing and we remain highly concerned that ESMA's ability, expertise and agility to adequately and timely review, mediate and resolve any complaints will not be sufficient.

### **In respect of Eligibility for Mandated Clearing:**

- With respect to the scope of products eligible for the clearing requirement, the WMBA believe standards should contain the requirements that the product should: (a) be made available to be centrally cleared at multiple CCPs which are authorised or recognised in a third country by ESMA and the relevant national supervisor; (b), be available for multilateral execution on organised trading venues and reported to trade repositories for supervisory review; (c) be made available for electronic straight-through-processing; (d) have standardised identifiers; (e) be suitable for fully electronic confirmation and affirmation; (f) be suitable for processing by an approved trade repository; and (g) be able to be supported by compression, aggregation, and netting of trades for capital efficiency.
- WMBA would also encourage ESMA to develop a set of principals whereby commonly netted sets of derivatives or derivatives traded against cash underlying are exempt from the clearing requirement in order to lower systemic risk and seek as efficient a use of collateral as possible. We especially urge ESMA to carefully consider the treatment of the FX markets in this respect where the separation of derivatives from their requisite hedges would appear counterproductive, whilst this area also highlights the international convergence that is required for products commonly traded between regulatory regimes.

### **In respect of Transaction Reporting to Repositories:**

- WMBA believes that a standardised and consistent approach to transaction reporting, whether it be under MiFID II, the European Market Infrastructure Regulation (EMIR), the Regulation of Energy Market Integrity and Transparency (REMIT) and the Short Selling Directive (SSR), needs to be implemented. Consequently, WMBA feels that the timing of this initiative should be delayed until there is a coherent approach. If ESMA is publishing new standards on transaction reporting with the intention of only covering the transition between MiFID and MiFID II, it could create unnecessary extra regulatory costs for European banks and investment firms.

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- Furthermore, WMBA calls on ESMA to avoid duplication of reporting when preparing technical standards on transaction reporting for the above legislation. For example, trades reported to a trade repository which is not a registered ARM, or the energy regulator, should not be reported again to the competent authority. The competent authority should have access to any trade repositories and ACER data.
- WMBA considers that a clear definition of “transaction” is needed for transaction reporting purposes. In the current MiFIR, Article 5 states “transaction means the purchase and sale of financial instruments and excludes specifically securities financing transactions, exercise of options, or of covered warrants, as well as primary markets transactions”; however, this has not been included in MiFID II/MiFIR. Whilst WMBA is aware that this definition will need to be modified to cover the additional scope of regulation, WMBA believes that this definition is still fundamentally sound.
- Under the new regulations, WMBA members will be operating as both MTFs and OTFs in either a matched principal capacity where they execute trades, and in an arranging capacity where they do not (when arranging a trade, WMBA members only introduce clients to one another and do not act as agent for either client). Under the current MiFID transaction reporting rules, there is no requirement to report any trades that are purely arranged by our members (see above). However, WMBA are concerned that Article 23 Paragraph 5 which states “The operator of a regulated market, MTF or OTF shall report details of transactions in instruments traded on their platform which are executed through their systems by a firm which is not subject to this Regulation in accordance with Paragraphs 1 and 3” may, without clarification of the definition of “executed through their system”, result in pure arrangers having to develop systems to transaction report on behalf of their clients.
- We note and concur with the EMSA acknowledgement of the “*extremely short time given for consulting on such a number of measures*” and query why it the case, as observed in all the previous consultations by both ESMA and the Commission, that an undoubtedly important piece of work need to be hurried through due process in a fraction of the necessary time over the major vacation time of year. Given the length of the timeframe from the 2008 Pittsburgh G20 to the full implementation of the Basle program is in the order a decade, it would seem that such hurried measures may prove ultimately either slower or with more negative and unintended outcomes than those envisaged.
- We agree with ESMA that an essential element for the drafting of technical standards is the analysis of the cost and benefits that the proposed measures might entail, and urge that this is done thoroughly and with a more complete transparency than has been the case in related fields recently.
- WMBA members, acting as wholesale market intermediaries, are concerned about their inability to source the required data in respect of the underlying client (WMBA members would normally only retain records of their immediate client and would not be aware of that client’s underlying client, ie, the end user in a chain, to do so would conflict and cause a heavy burden under current Anti-Money Laundering legislation). They are also concerned about the cost benefit of reporting this information to the authority (including client category and

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persons within the investment firm responsible for investment decision or executing the order, this goes against the common principal that it is the entity that is party to the transaction and not an individual within that entity). WMBA would recommend that this information should not be mandatory reported but be made available, on request, to the competent authority by each firm within the chain.

- In respect of the reporting of Trade Repositories, EMIR RTS should outline the position management and reporting at entity level. Currently such proposals are firmly within the scope of MiFID, MAD and SSR proposals through ongoing requests by legislators for venues to enforce any position limits and management that may be deemed necessary. It remains self evident that this is the exact responsibility of trade repositories whereas venues can only report the flows transacted and the identity of the executing counterparties. Venues are unable to report the static risk profiles of the underlying legal beneficial owners standing behind the trade.

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### Annex 1

#### Wholesale Markets Brokers' Association & London Energy Brokers' Association

The Wholesale Markets Brokers' Association (WMBA) and the London Energy Brokers' Association (LEBA) (referred to in this document as the WMBA) are the European industry associations for the wholesale intermediation of Over-the-Counter (OTC) markets in financial, energy, commodity and emissions markets and their traded derivatives. Our members are Limited Activity & or Limited Licence firms that act solely as intermediaries in the said wholesale financial markets. As Interdealer Brokers (IDBs), the WMBA members' principal client base is made up of global banks and primary dealers. The replies below to the questions in the paper should be seen in the context of WMBA members acting exclusively as intermediaries and not as own account traders. (Please see [www.wmba.org.uk](http://www.wmba.org.uk) and [www.leba.org.uk](http://www.leba.org.uk) for information about the associations, its members and products.) For this reason, some of the questions in the Consultation Paper are not entirely relevant to WMBA members' activities even though they are to most of their clients. Further, some answers take into account industry views and experience.

Operating as the hub of the global financial market infrastructure, IDBs are MiFID compliant and highly regulated intermediaries by virtue of their regulatory authorisation and from being subject to supervision under CAD as Limited Activity or Limited Licence firms. Our members are neutral, independent, and multi-lateral, and provide free, fair and open access to their trading venues for all suitably authorised and regulated market participants. IDBs do not take positions in the markets in which they operate and their collective service as the gateway to the global financial marketplace creates price discovery and significant liquidity. All transactions, whether executed via voice, hybrid or fully electronic means, are immediately captured at the point of trade, are subject to straight-through-processing and are made available for transparent and timely transaction reporting to the relevant regulators.

#### **WMBA Members:**

- BGC Partners
- EBS Group Ltd
- GFI Group Inc
- Gottex Brokers SA
- ICAP plc
- Martin Brokers (UK) Ltd
- Reuters Transaction Services Ltd
- Sterling International Brokers Ltd
- Tradition (UK) Ltd
- Tullett Prebon plc
- Vantage Capital Markets LLP

#### **LEBA Members:**

- Evolution Markets Ltd
- GFI Group, Inc
- ICAP Energy Ltd
- PVM Oil Associates Ltd
- Spectron Group Ltd
- Tradition Financial Services Ltd
- Tullett Prebon Energy Ltd

For further information please visit [www.wmba.org.uk](http://www.wmba.org.uk) and [www.leba.org.uk](http://www.leba.org.uk)

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**Contact**

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ESMA will consider all comments received by **5 August 2012**.

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