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Common problems in implementing the capital markets Regulations

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OTC Derivatives Market Reforms: Eleventh FSB Progress Report on Implementation

Trade reporting: requirements covering over 90% of OTC derivative transactions were in force as at 30 June 2016 in 19 out of 24 FSB member jurisdictions; by end-2017, 23 of these jurisdictions expect to have such requirements in force.

Central clearing: the majority of FSB jurisdictions (14) had in force frameworks for determining when standardised OTC derivatives should be centrally cleared that cover over 90% of OTC derivative transactions.

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Capital and margin: while higher capital requirements for exposures to NCCDs are largely in force (with 20 jurisdictions having requirements in force that apply to over 90% of OTC derivatives transactions), less progress has been made in the implementation of margin requirements for NCCDs.

Platform trading: Frameworks for determining mandatory platform trading requirements are in force in 11 jurisdictions, and requirements are in place in three jurisdictions. Few other jurisdictions have further implementation steps planned.

IOSCO Principles and Methodology

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- Important document for assessment by international bodies, e.g. the IMF and World Bank and tool for capacity building
- Revised Methodology after 5 year revision cycle to be adopted at the IOSCO Annual Conference in May 2017
- Latest revision factored in the OTC derivatives markets reform

IOSCO Principles and Methodology

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- Basic goal is to have fair, efficient and transparent markets
  » link to investor protection and intermediaries' standards
- Recently, technology drove a number of changes regarding secondary markets, e.g. rise of non-exchange trading systems and automation of trading
- Markets have important economic function to finance real economy and indicate state of major national companies
- Principles have a wide scope, covering markets *"in its widest sense"*, thus including OTC derivatives markets.

IOSCO Principles and Methodology

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Principle 37

"*Regulation should aim to ensure the proper management of large exposures, default risk and market disruption*."

While the wording of the Principle is fairly abstract, the revised Methodology deals with the OTC derivatives markets reform under this Principle.

IOSCO Principles and Methodology, Principle 37

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The following new requirements were added:

New Key Issue 10: Transactions in OTC derivatives markets

- Trading obligation
- Clearing obligation
- Margining requirements for NCCDs
- Risk mitigation standards for NCCDs
- Reporting to Trade Repositories

Corresponding Key Questions 9-19

IOSCO Principles and Methodology, Principle 37

Examples of Key Questions for Implementation Monitoring:

- 9. Are standardized OTC derivatives contracts with a suitable degree of liquidity required to be traded on “exchanges or electronic trading platforms” provided that a flexible approach encompassing a range of platforms that would qualify as “exchanges or electronic trading platforms” for OTC derivatives is taken?
- 11. Are standardized OTC derivatives required to be cleared through CCPs? In particular, has the market authority a clear process in place for the determination that a product or set of products should be subject to a mandatory clearing obligation?

IOSCO Principles and Methodology, Principle 37

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Scenario example on Benchmarking:

- In country X standardised interest rate swaps have to be centrally cleared. However, authorities have not required such a class of derivatives to be traded on-exchange, because intermediaries prefer to transact bilaterally.
- Grading would be „not implemented", because of inability to respond affirmatively to Key Question 11.
  The trading obligation is a key concept which has to be fulfilled.

IOSCO Principles and Methodology, Principle 37

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Second scenario example on Benchmarking:

- In country Y there are no particular requirements for NCCDs, e.g. regarding margining or risk-mitigation techniques.
- Grading „Partly implemented" possible, because for this result Key Questions 14 and 15 do not have to be responded to affirmatively.

» Deficits in the area of NCCDs, altough not unimportant, are considered less severe compared to central requirements like the clearing and trading obligation and reporting to TRs.

Implementation issues in the EU

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- EU Commission sees room for improvement of EMIR in the following areas:
  - Alleviations on reporting obligations:
    - For on-exchange transactions the CCP will report for both counterparties
    - No reporting of intra-group transactions, if one counterparty is a non-financial entity
    - Transactions between big and small non-financials will be reported by big counterparty only

Implementation issues in the EU

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- EU Commission sees room for improvement of EMIR in the following areas:
  - Non-financial counterparties:
    - If size threshold of transactions is reached, not all, but only the class of instruments that lead to the trigger of the threshold will be subject to the clearing obligation
  - Small financial counterparties:
    - Introduction of a volume threshold, below which the central clearing obligation is not applicable

Implementation issues in the EU

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- EU Commission sees room for improvement of EMIR in the following areas:
  - Pension funds:
    - Introduction of three year exemption period for pension funds from the central clearing obligation, during which a solution is worked on to participate in central clearing in a cost-effective manner.

Implementation issues in the EU

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- German financial industry participants see room for improvement of EMIR in the following areas:
  - Facilitate exemptions for intra-group transactions
  - Proportionate treatment of participants generating lower transaction volume
  - Reconsider dual-side reporting

Implementation issues in the EU

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- BaFin practical experiences:
  - Information about obligations according to EMIR on BaFin homepage helpful for market participants
  - BaFin also issued FAQs to address country-specific questions besides the ESMA FAQs, for example:
    - Treatment of municipalities and public institutions
      » either exemption or categorization as non-financial entities
    - Treatment of take or pay clauses in the energy sector
      » generally not considered a derivative contract
    - Treatment of branches
      » EMIR obligations rest with the „mother“ company

Many thanks for your attention!

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