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Council reaches agreement on measures to regulate derivatives market

The Council today[1] set out its position with a view to negotiations with the European Parliament on a draft regulation aimed at increasing transparency and reducing risk in the over-the-counter[2] (OTC) derivatives market (15148/11).

The draft regulation calls for reporting of all derivative contracts to trade repositories (i.e. central data centres) and the clearing of standardised[3] OTC derivative contracts through central counterparties (CCPs)[4] in order to reduce counterparty risk (i.e. the risk of default by one party to the contract). This is aimed at preventing the default of one market participant causing the collapse of other market players, thereby putting the entire financial system at risk. To be authorised, a CCP would, inter alia, have to hold a minimum amount of capital.

The regulation is aimed at implementing commitments made by G-20 leaders in September 2009[5]. It would apply from the end of 2012.

The compromise proposed by the presidency allows room[6] for further technical work, in the context of trilogue negotiations with the European Parliament, on how to negotiate and bring into force arrangements with third countries.

For details, **see ANNEX**.

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1 The agreement was reached at a meeting of the Economic and Financial Affairs Council.
2 A derivative not traded on an exchange but instead privately negotiated between two counterparts.
3 Those that have met predefined eligibility criteria
4 CCPs are entities that interpose themselves between the two counterparties to a transaction and thus become the 'buyer to every seller', as well as the 'seller to every buyer'
5 The Commission confirmed that it will continue to fully implement all existing G-20 commitments, including in relevant future legislative initiatives.
6 Through a statement to the minutes.

P R E S S

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Background

One year after the collapse of Lehman Brothers, a major player in OTC derivatives markets, G-20 leaders agreed in Pittsburgh that all standardised OTC derivative contracts should be cleared through CCPs by the end of 2012, while non-centrally cleared contracts should be subject to higher capital requirements. They also resolved that OTC derivative contracts should be reported to trade repositories.

Accordingly, the draft regulation would require the reporting of all derivative contracts to trade repositories (i.e. central data centres) and the clearing of standardised[1] OTC derivative contracts through central counterparties (CCPs)[2].

If a contract is not eligible for clearing by a CCP, the draft regulation would require the application of different risk management techniques, including, for instance, exchange of collateral and the holding of additional capital.

Trade repositories would have to publish aggregate positions by class of derivatives, thereby offering market participants a clearer view of the OTC derivatives market. The European Securities and Markets Authority (ESMA) would be responsible for the surveillance of trade repositories and for granting and withdrawing their registration.

The compromise proposal provides for venues of execution to have access to any CCP to clear OTC derivatives transactions and, subject to conditions, for CCPs to have access to the trade flows from trading venues.

ESMA would be responsible for the identification of contracts subject to the clearing obligation, while national competent authorities, in coordination with a college of supervisors[3], would be responsible for authorising and supervising CCPs, except in the case of CCPs from third countries, which would have to be recognised by ESMA provided they meet certain conditions.

Authorisation of a CCP would always require, as a first condition, that the national competent authority is fully satisfied that the applicant CCP meets all the necessary requirements.

On the other hand, a positive opinion from the national competent authority could be overruled by the college of supervisors only if all of its members, excluding the authorities of the member state concerned, reach a mutual agreement that the CCP should not be authorised. Moreover, the draft proposal stipulates that no member state can be discriminated as a venue for clearing services.

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[1] Those that have met predefined eligibility criteria

[2] CCPs are entities that interpose themselves between the two counterparties to a transaction and thus become the 'buyer to every seller', as well as the 'seller to every buyer'

[3] The college will consist of the competent authorities supervising the CCP as well as the entities which might be affected by its operations.

A CCP would be required to have a mutualised default fund to which members of the CCP would have to contribute.

The obligation to clear OTC derivatives contracts through a CCP and report them to trade repositories would apply to financial firms, while non-financial firms would only be subject to the rules if their OTC derivatives positions reach specified information and clearing thresholds, to be set by ESMA and the Commission, and are considered to be systemically important. Pension schemes would be exempt from the clearing obligation for a period of three years, extendable by another two years through a review clause.