MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

March 19, 2012

Via Electronic Submission: www.esma.europa.eu

European Securities and Markets Authority
103 Rue de Grenelle
75007 Paris France

Re: ESMA Discussion Paper on Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories

Dear Sir or Madam:

Managed Funds Association[1] welcomes the opportunity to provide comments to the European Securities and Markets Authority ("**ESMA**") in response to its Discussion Paper (the "**Discussion Paper**")[2] on Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories.[3] Throughout the EMIR legislative process, MFA engaged with policy makers in the European Union ("**EU**") to provide thoughtful and constructive input on a number of important issues related to over-the-counter ("**OTC**") derivatives. MFA strongly supports efforts to promote central clearing and thereby: (i) increase transparency of the derivatives market; (ii) reduce counterparty and operational risk in trading; and (iii) enhance market integrity and oversight. MFA strongly supports the goals and efforts of the EU to reduce systemic risk in the derivatives market, including by transitioning the OTC derivatives market to greater central clearing. In addition, MFA continues to support measures that enhance transparency in the derivatives market as well as consistency of regulation globally.

MFA would like to take this opportunity to provide comments on a number of the questions ESMA set out in the Discussion Paper. We are hopeful that these comments will assist ESMA in preparing technical standards that will implement EMIR in a manner that is efficient and workable for market participants. Although this response covers several important issues, we will first highlight two key points that we raise in this letter in response to the Discussion Paper questions.

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[1] Managed Funds Association ("**MFA**") represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

[2] Available at: http://www.esma.europa.eu/system/files/2012-95.pdf.

[3] *See* the European Commission's "Proposal for a Regulation of the European Parliament and of the Council on OTC derivative transactions, central counterparties and trade repositories" ("**EMIR**").

I. CCP Governance

MFA strongly believes that clients[4] should have their views reflected in the critical decisions of central counterparty ("**CCP**") governing bodies. Clients are crucial stakeholders in the derivatives markets in that they: (i) collectively represent, for most derivatives asset classes, a significant portion of the outstanding risk and open interest; (ii) have interests that are highly aligned with the EMIR core goals of mitigating systemic risk conjoined with increasing transparency, efficiency and competition; (iii) have sophisticated derivatives product and risk management expertise; (iv) have significant knowledge about the issues market participants encounter when seeking direct and indirect clearing membership and access to best execution; and (v) can act as a counterbalance to historically aligned and concentrated dealer interests.

Thus, MFA welcomes the provisions in EMIR, which require participation of clients in the risk committees of CCPs[5] and strongly encourage ESMA to promulgate technical standards that mandate appropriate levels of transparency and client participation. We also support the requirements in EMIR that affirmatively limit the representation of any group on CCP committees to a percentage lower than a controlling majority.[6] We believe these requirements are essential to the mitigation of conflicts of interest, and in this regard, we make some additional recommendations below in response to Q24 and Q25 of the Discussion Paper that we believe will help to mitigate further any potential conflicts of interest within CCPs governance structure.

II. Straight-Through Processing

MFA is concerned that arrangements for client clearing, whether direct or indirect clearing, could impose barriers on clients' ability to access clearing and competitive execution. In particular, it is important that such arrangements do not expose clients to the credit risk of their executing counterparty, which would undermine the risk reduction purpose of clearing. To address this concern, MFA has advocated consistently and strongly for straight-through processing of trades.[7] Moreover, in the U.S., the Commodity Futures Trading Commission

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[4] *i.e.*, those entities that undertake a contractual relationship with a clearing member that enables them to clear transactions with the relevant CCP.

[5] Article 26 of EMIR requires that CCPs establish risk committees and that those committees include representatives of clients as well as clearing member representatives and independent representatives. None of the groups represented on such a committee will have a majority. A CCP risk committee will advise the board of the CCP on any arrangements that might impact the risk management of the CCP.

[6] Article 26(1) of EMIR.

[7] *See e.g.*, MFA's Updated Response on Proposed Regulation on OTC Derivatives, Central Counterparties and Trade Repositories, dated January 19, 2012, available at: https://www.managedfunds.org/wp-content/uploads/2012/01/Final_MFA_Updated_WhitePaper_on_EMIR.pdf; MFA's comment letter to the CFTC on its proposed rulemakings on "Customer Clearing Documentation and Timing of Acceptance for Clearing" and "Clearing Member Risk Management", dated September 30, 2011, available at: http://www.managedfunds.org/wp-content/uploads/2011/10/CFTC_Customer.Clearing.Documentation.and_.Timing.of_.Acceptance.for_.Clearing_Clearing.Member.Risk_.Management_FinalMFALetter.pdf; and MFA's comment letter to the CFTC on its proposed rules on "Requirements for Processing, Clearing, and Transfer of Customer Positions", dated April 11, 2011, available at: http://www.managedfunds.org/wp-content/uploads/2011/06/4.11.11-CFTC-Customer-Positions-Rules-Final-MFA-Letter.pdf.

("**CFTC**") has demonstrated its robust support for straight-through processing by issuing a proposed rulemaking[8] that seeks to minimise the time between trade execution and acceptance into clearing and that mandates straight-through processing for transactions executed on a designated contract market or swap execution facility, as well as transactions executed outside an execution platform and submitted for clearing.[9] Straight-through processing of trades benefits all market participants, especially smaller market participants and alternative liquidity providers that could otherwise encounter barriers to entry. Straight-through processing is beneficial in that it: (i) gives market participants certainty of clearing immediately following execution, which in turn, allows them to hedge more efficiently and effectively manage risk; (ii) is an important factor in encouraging the implementation of broad, mandatory clearing; (iii) is essential to electronic trading, particularly limit order book trading; and (iv) promotes accessible, competitive markets and access to best execution by ensuring parties to a cleared trade have immediate confirmation that they will face the CCP, thus eliminating the need to negotiate individual arrangements with each of their counterparties.

MFA believes that if a client faces any delay in a CCP's acceptance of any trade for clearing, it will result in the client trading with fewer counterparties, and by extension, increase concentration in the market, since it is typically the largest dealers that pose lower long-term counterparty credit risk and with whom clients are more likely to have in place bilateral master agreements. CCPs have a strong interest in ensuring the solvency of clearing members, and thus, straight-through processing can broaden the number of suitable counterparties available and increase competition among them. Therefore, we feel strongly that failure to mandate straight-through processing timeframes undermines the fundamental policy goals of clearing by limiting optimal risk management, competitive liquidity and open access to the market.

Given the benefits of straight-through processing, MFA respectfully requests that ESMA work with a view to ensuring the same real-time processing timeframe for all trades submitted for clearing, regardless of the execution method used or whether or not the trade is subject to mandatory clearing. In addition, to facilitate international harmonization of regulations and to ensure full realization of the benefits of client clearing, we believe that ESMA should draft technical standards on client clearing models, whether direct or indirect, that support straight-through processing.[10]

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[8] We note that the CFTC has scheduled an open meeting for March 20, 2012, at which time it is expected that the CFTC Commissioners will vote on and approve these rules as final.

[9] CFTC Notice of Proposed Rulemaking on "Customer Clearing Documentation and Timing of Acceptance for Clearing", 76 Fed. Reg. 45730 (Aug. 1, 2011) ("**CFTC Customer Clearing Documentation Rules**"), available at: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-19365a.pdf.

[10] *See Id.* at 45732, where the CFTC has noted that arrangements that could delay acceptance of trades into clearing may conflict with the concepts of open access to clearing and has sought in its rulemaking to prohibit such arrangements.

III. MFA Reponses to ESMA's Discussion Paper Questions

Contracts having a direct, substantial and foreseeable effect within the EU (Article 3)[11]

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?

MFA encourages ESMA to draft technical standards that set out clear and precise criteria about when it will consider a contract to have a "direct, substantial and foreseeable effect within the EU" as well as where it is necessary or appropriate to apply the clearing obligation to contracts between third country counterparties in order to prevent the evasion of EMIR. Without clear, comprehensive guidance, market participants will have uncertainty as to when the EMIR clearing obligation will apply and it will be difficult for third country entities to ensure compliance with their obligations. In particular, where ESMA does not appropriately specify the jurisdictional scope, market participants may be subject to conflicting clearing mandates from multiple regulators, which will render compliance impossible and harm the effectiveness of the various regulations. Even with contracts that ESMA deems to have a direct, substantial and foreseeable effect within the EU, there may be circumstances in which ESMA would not require clearing of them by an EU CCP if they are cleared in a third country with equivalent rules. Therefore, MFA encourages ESMA to coordinate closely with U.S. and other international regulators in setting jurisdictional limits to ensure that regulatory reform is consistent, where applicable, and addresses counterparty and systemic risk, while permitting access to, and competition among, CCPs organized in countries outside the EU.[12]

MFA believes that, at present, considerable uncertainty exists with regard to the extraterritorial application of EMIR. In providing clear guidance, we would ask ESMA to ensure that any extraterritorial application considers the potential global impact of imposing onerous obligations on a large number of market participants worldwide. In particular, we would appreciate ESMA providing guidance considering each of the following: fund domicile, manager domicile, reference entity domicile, market location, reference security, underlying instrument and counterparty domicile. Specifically, ESMA should make it explicitly clear that transactions between two third country entities are not within the scope of EMIR simply because there is an EU reference security or other underlying instrument. In addition, ESMA should clarify that a derivatives trade by a non-EU fund referencing non-EU securities or taking place on a non-EU

[11] Discussion Paper at 6, paragraphs 8 and 9. ESMA seeks input on the EMIR requirement that counterparties to OTC derivatives between third country entities would be subject to the clearing obligation if, among other things, those OTC derivative contracts 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.

[12] We note that, in the U.S., the CFTC and the U.S. Securities and Exchange Commission ("**SEC**") expect to provide further guidance as to the extraterritorial application of U.S. requirements in due course.

market is not subject to the clearing mandate solely because that fund has an EU investment manager.[13]

In the event ESMA subjects a contract between two third country counterparties to the EMIR clearing mandate due to the contract having an EU reference security or other underlier, MFA recommends that, for it to be deemed to have a "direct, substantial and foreseeable" effect within the EU, ESMA also require the contract, at a minimum, to meet all of the following characteristics:

(i) (a) in the case of derivatives referencing a security, such as equity derivatives and credit default swaps (or an index of such derivatives), the reference entity must be domiciled in the EU and have a principal of business in the EU; (b) in the case of foreign exchange derivatives, Euro or another EU member currency must be one of the relevant currencies; or (c) in the case of interest rate derivatives, the denomination must be in Euros or another EU member currency;

(ii) the settlement currency of the contract must be in Euros or another EU member currency; and

(iii) the notional amount of the contract must be substantial. MFA suggests that it be the greater of: (i) 1% of outstanding open interest of such contract (calculated on a global basis); and (ii) €500 million (or equivalent).

For an index or basket derivative, in addition to clauses (ii) and (iii) above, MFA believes the majority of the underlying reference entities must meet clause (i) above. Minimum standards such as those enumerated above will ensure that there is an appropriate materiality threshold.

Types of indirect clearing arrangement (Article 3)[14]

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

It is essential that the technical standards proposed by ESMA ensure that, as required by EMIR,[15] the assets and positions of a counterparty participating in indirect clearing benefit from

[13] For example, an EU investment manager of a Cayman Islands fund that enters into a derivatives trade referencing a Hong Kong security with a U.S. counterparty in order to hedge the risk of a U.S.-traded American Depository Receipt ("**ADR**"), which correlates the amount of reference securities to the ADR, should not be subject to EMIR.

[14] Discussion Paper at 6, paragraphs 10 and 11. ESMA seeks input on what types of indirect contractual arrangements should meet the EMIR requirement that indirect clearing arrangements must not increase counterparty risk and must ensure that the assets and positions of the counterparty benefit from the protection granted by segregation, portability and default procedures.

[15] Article 3(2) of EMIR provides that to comply with the clearing obligation a counterparty shall become a clearing member, a client or shall establish indirect clearing arrangements with a clearing member, provided that these arrangements do not increase counterparty risk and ensure that the assets and positions of the counterparty benefit from the protections with equivalent effect to those referred to in Article 37 (Segregation and portability) and Article 45 (Default procedures).

the protection granted by segregation, portability and default procedures. MFA is concerned that in the absence of clear direction from ESMA, indirect clearing models could erect anticompetitive barriers to client clearing and fail to offer such protections in a satisfactory manner.

MFA submits that ESMA should mandate that all client clearing models at a minimum: (1) provide straight-through-processing of trades, as discussed in Section II above; (2) require segregation of client positions and initial margin at all times equivalent to direct clearing; and (3) prohibit constraints on a client's ability to procure competitive execution, as discussed below.

Indirect Contractual Arrangements

MFA notes that in the OTC derivatives market, counterparties must negotiate specific credit agreements, either directly on a bilateral basis or trilaterally with the involvement of a guarantor or credit intermediary. Negotiation and ongoing administration of such arrangements is time-intensive, costly and necessarily limits the number of transacting counterparties available to a participant. These arrangements also tend to concentrate trading activity amongst those firms that are deemed the most secure from a credit perspective.

Where central clearing exists, the need for execution documentation as well as credit intermediation or other credit arrangements is limited. Specifically, where counterparty credit risk is managed through the clearing framework, the only documents necessary for a market participant to enter into cleared trades are the CCP rules and a clearing arrangement.[16] MFA strongly urges ESMA to adopt technical standards that: (i) specify that clearing agreements between clearing members and their clients must include appropriate segregation, portability and default protections and provide for straight-through processing; (ii) prohibit clearing agreements from tying execution to clearing; and (iii) support clients' ability to access competitive execution.

MFA also submits that ESMA should prohibit the creation of credit sub-limits for clients. In the U.S., the CFTC discussed this concern by referencing the FIA–ISDA Cleared Derivatives Execution Agreement, which would permit a client's futures commission merchant ("**FCM**", the entity that clears on behalf of the client) in consultation with its swap dealer ("**SD**"), to establish specific credit limits for the client's swap transactions with the SD, and to declare that the FCM will only accept transactions for clearing that fall within these specific limits.[17] The effect would be to create a "sublimit" for the client's trades with that SD, which would: (i) restrict a client's counterparties because, without such sub-limits, the client may enter into transactions with whomever it chooses up to its overall limit with the FCM; (ii) reveal the identity of the client's

[16] The clearing arrangement is in the form of a clearing membership agreement where the participant is a direct clearing member under the CCP's rules or, for a client of a clearing member, a clearing agreement with that clearing member.

[17] *See* CFTC Customer Clearing Documentation Rules at 45731, referencing the template published by the Futures Industry Association and the International Swap and Derivatives Association, Inc., which swap market participants would use in negotiating execution-related agreements with counterparties to cleared swaps.

counterparty to the FCM; and (iii) delay acceptance of the trades into clearing while the FCM verifies compliance with the sub-limits.[18]

Clearing arrangements with such sub-limits conflict with the principles of open access to clearing and execution of client transactions on terms that reasonably relate to the best terms available, and could lead to undue influence by FCMs on a customer's choice of counterparties (or, conversely, undue influence by SDs on a customer's choice of clearing member).[19] Therefore, to be consistent and harmonize with the CFTC's proposal in the U.S.,[20] we urge ESMA to draft technical standards that similarly prohibit such anticompetitive indirect clearing arrangements.[21] Indeed, CCP rules should not permit any anticompetitive behaviour or leave open the possibility of clearing members adopting restrictive practices, as described above.

Straight-Through Processing

As discussed in Section II above, as part of a client clearing policy, MFA is keen to ensure that ESMA facilitates immediate acceptance or rejection of a trade upon submission for clearing, including for indirect clearing by clients. Such straight-through processing will eliminate systems that impose additional credit limits, fragment liquidity, delay acceptance of trades and/or impose barriers to client access to clearing. In addition, providing open access to straight-through processing of trades will promote market efficiency by enabling market participants to reduce their counterparty credit risk without delay and by ensuring unrestricted access to the broadest range of executing counterparties, more liquidity and competitive pricing. Straight-through processing will also enhance market transparency and protect the anonymity of a customer's executing counterparties. Therefore, we respectfully request that ESMA implement technical standards that prevent CCPs and clearing members from adopting measures that disadvantage or discriminate against clients, especially in respect of participant eligibility and the timing for clearing trades.

Alternative Approaches

MFA notes that a form of "indirect clearing" has emerged as a potential alternative approach to the futures or other established agency-based models for clearing that accomplish the key goals of segregation and straight-through processing articulated above. While to our knowledge, a framework for this suggested alternative has not been fully elaborated, we

[18] *See Id.* at 45731.

[19] *See Id.* at 45732.

[20] *See Id.* at 45737. In §23.608 of the CFTC Customer Clearing Documentation Rules, the CFTC proposed to prohibit an arrangement with a customer that: (A) discloses to the FCM or any SD or major swap participant the identity of a customer's original executing counterparty; (B) limits the number of counterparties with whom a customer may enter into trades; (C) restricts the size of the position a customer may take with any individual counterparty, apart from an overall limit for all positions held by the customer at the futures commission merchant; or (D) impairs a customer's access to execution of a trade on terms that have a reasonable relationship to the best terms available.

[21] We note that the CFTC has scheduled an open meeting for March 20, 2012, at which time it is expected that the CFTC Commissioners will vote on and approve these rules as final.

understand that it contemplates the interposition of a non-clearing member in the trade and clearing flow between the client and the direct clearing member. While MFA is still examining such arrangements with a particular view to understanding the specific cases in which it might be of incremental benefit as compared to a straightforward, futures-like, agency client clearing approach, we emphasize that if ESMA permits such alternative arrangements, ESMA must require that parties structure such arrangements to ensure that:

(1) they are subject to straight-through processing requirements, so that there is no period of counterparty credit risk exposure between the client and its executing counterparty;

(2) the arrangement does not at any time weaken or undermine the segregation of the client's positions and initial margin from the insolvency of any party, such as would be available on a direct clearing basis;[22] and

(3) such an arrangement does not: (i) impose any constraint on a client's ability to procure competitive execution; or (ii) otherwise restrict or disincentivize a client from separating execution from clearing in seeking to procure competitive execution in the relevant derivatives marketplace.

Risk mitigation for non-CCP cleared contracts - timely confirmation (Article 6 /8)[23]

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?

MFA generally supports efforts to improve the efficiency and timing for confirming the terms of any contract not cleared by a CCP as it may reduce operational risk in the derivatives market.[24] We agree that the fact that non-cleared trades are suitable for electronic processing should impact the timing of the confirmation. However, we are concerned that ESMA's proposed standards will modify current market practice, particularly where the parties do not confirm the terms of the OTC derivative electronically. Under current practice, parties execute a transaction with the expectation that they will negotiate non-economic terms after execution,

[22] Thus, this requirement would expressly exclude "back-to-back" arrangements that would not support segregation or any other arrangement whereby an intermediary takes the client's initial margin into such intermediary's working capital.

[23] Discussion Paper at 12, paragraphs 37 to 41. ESMA seeks to comply with the EMIR risk mitigation mandate for financial and non-financial counterparties entering into an OTC derivative that is not subject to the clearing obligation by proposing different timeframes for the confirmation of OTC derivative terms that exceed the clearing threshold, such timeframes dependent on whether the parties electronically execute and/or process the transaction.

[24] *See* MFA's comment letter to the CFTC on its proposed rulemaking on "Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants", dated February 28, 2011 ("**MFA's Portfolio Compression Letter**"), available at: http://www.managedfunds.org/wp-content/uploads/2011/06/2.28.11-CFTC.Portfolio.Reconciliation-Compression.Rules_.Final_.MFA_.Letter.pdf.

which is more often the case for complex or customized swaps where the counterparties must negotiate allocation of the legal risks and rights. If ESMA implements the proposed timing requirements for the confirmation of all terms of a trade, parties may be unable to enter into certain trades if they cannot agree on terms in time, or it will force parties to agree to unfavourable trade terms, most often to the detriment of the client who must sign a form of confirmation drafted by its dealer counterparty.

Therefore, MFA recommends that ESMA draft the relevant technical standards so that the proposed timing requirements only apply to the delivery of a trade acknowledgment (*i.e.*, only the primary economic terms of the transaction). For non-economic terms, we respectfully request that ESMA allow parties a longer time to complete negotiation of those terms by mandating that the deadline for confirmation be the end of the business day following the execution of the trade. In addition, MFA recommends that ESMA permit extensions of this deadline for bespoke or particularly complex non-cleared trades to ensure that ESMA does not penalize parties where the delay in confirmation results from them carrying on negotiations of the terms in good faith.

MFA recognizes that ESMA's proposal tracks the language of the CFTC's proposal,[25] and that ESMA is particularly concerned about harmonizing its technical standards with the regulations adopted by its U.S. counterparts. We note that MFA has submitted these comments to the CFTC on its equivalent proposed rules and we await its response.[26] In addition, as ESMA is aware, the Dodd-Frank Act did not give the CFTC jurisdiction over all non-cleared, U.S. derivative products.[27] Rather, the SEC has jurisdiction over "security-based swaps", which under the current proposed U.S. definitions include a number of the more bespoke and customized transactions for which market participants might need a longer time to confirm the non-economic terms.[28] As of the date of this letter, the SEC has not issued a proposed rule on timing of confirmations for security-based swaps. As a result, the effect of ESMA's proposed technical standards will actually exceed what its U.S. counterparts have currently proposed because it will apply to all derivatives contracts.

In addition, MFA would be grateful if ESMA could clarify the meaning of "electronically processed". On the one hand, the term could mean the entry of trade information into a trade capture system, which upon receiving trade information, generates an acknowledgment that it sends to the counterparty electronically. On the other hand, the term could refer to electronic matching platforms, which allow parties to enter trade terms for matching. Since transactions

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[25] *See* CFTC Notice of Proposed Rulemaking on "Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants", 75 Fed. Reg. 81519, 81531 (Dec. 28, 2010), available at: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-32264a.pdf.

[26] *See* MFA's Portfolio Compression Letter.

[27] *See* CFTC and SEC Joint Proposed Rule; Proposed Interpretation on "Further Definition of 'Swap Dealer,' 'Security-Based Swap Dealer,' 'Major Swap Participant,' 'Major Security-Based Swap Participant' and 'Eligible Contract Participant'", 75 F.R. 80174 (Dec. 21, 2010), available at: http://www.gpo.gov/fdsys/pkg/FR-2010-12-21/pdf/2010-31130.pdf.

[28] *Id.*

differ in complexity as well as in the number of bespoke provisions, the number of transactions that parties can enter into a trade capture system differs from the number of transactions for which matching platforms can capture all of the trade terms. Since this distinction is important for purposes of determining whether parties would have to confirm a trade within 30 minutes of the time of execution or by the end of the same calendar day, we would be grateful if ESMA could clarify the term "electronically processed".

Organisational Requirements (Article 24)[29]

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?

MFA agrees with ESMA that CCP governance arrangements should promote sound and prudent management, support financial stability and foster fair and efficient markets.[30] Balanced and effective CCP governance is critical to promoting competition in the derivatives market, and clients have an interest in sound governance requirements that foster fair and objective risk-based access, broad product offerings and competitive pricing. As discussed in Section I above, clients are crucial stakeholders in the derivative markets; therefore, we support an affirmative mandate in the technical standards that CCPs give non-dealer, client representatives on their risk committees the powers and tools necessary to enable clients to exercise their governance role effectively. MFA believes a key benefit of client representation in CCP governance is increased transparency as to the CCPs' operation, and we submit that measures that enhance client representation and participation will foster the transparency of, and therefore confidence in, CCPs. Client involvement in risk committee decisions will balance the decision-making process, help to mitigate potential conflicts of interest and improve the resolution of such conflicts.

MFA also recommends that ESMA mandate that CCPs adopt policies and procedures that subject any decision potentially resulting from conflicts of interests to checks and balances. In particular, where a CCP committee makes a decision, consistent with general corporate governance principals, a CCP's Board should have the ability to review and overturn such decision (subject to the EMIR provisions requiring reporting of such a decision).[31]

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[29] Discussion Paper at 16-18, paragraphs 65 to 69. ESMA seeks input on the technical standards it is required to draft specifying details of, among other things, CCP governance arrangements, compliance policies and procedures, disclosure of rules and governance arrangements and admission criteria. In general, ESMA's preliminary view is that: (i) governance arrangements should promote sound and prudent management; (ii) governance arrangements should be well-documented and include the policies, procedures and processes by which the board and senior management operate; (iii) a CCP should name dedicated individuals carrying on relevant functions because it is important to clearly identify the relevant contacts within the CCP; and (iv) a CCP should consider specific procedures for preventing and managing conflicts of interest including with respect to outsourcing arrangements.

[30] *Id*. at 17, paragraph 67.

[31] Article 26(5) of EMIR.

In addition, although MFA thinks that it is implicit that all members of CCP governing bodies have fiduciary duties to the CCP, we submit that ESMA should expressly set out the existence of these duties in the technical standards, which would reinforce the alignment of interests between governing body members and the CCP and further mitigate any potential conflicts of interest. Such duties may include (but not be limited to) obligations: (i) to exercise independent judgment; (ii) to avoid conflicts of interest; (iii) not to accept benefits from third parties; and (iv) to disclose an interest in a proposed arrangement.

As mentioned above, MFA believes a key benefit of client representation in CCP governance is increased transparency into CCPs. To enhance this transparency further, we support ESMA's proposal that the technical standards require disclosure of the CCPs' rules, governance arrangements and admission criteria.[32] In addition, we think that the technical standards should require public disclosure of, and access to, CCP committee charters and procedural rules in order to ensure that market participants that are unable to participate directly in CCP governance will have insight into the CCP's operations. MFA also recommends that each CCP make minutes of its governing bodies' proceedings publicly available to the extent it would not be prejudicial to business secrets. Lastly, MFA supports ESMA's proposal that a CCP name a chief risk officer, a chief technology officer and a chief compliance officer and we agree that identifying a CCP contact point is beneficial.[33]

Organisational Requirements - continued (Article 24)[34]

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?

MFA agrees that it is appropriate for ESMA's technical standards to require CCPs to disclose publicly all relevant information necessary to understand whether and how it meets its legal obligations. In addition, we also recommend that ESMA require CCPs to disclose all relevant information on their design and operations as well as on the rights and obligations of their clearing members and the clearing members' clients. As a significant proportion of the trading volume in the OTC derivatives market, clients are important participants, and thus, they should receive the same level of information as clearing members. It is important that clients are also able to identify, understand and manage the risks and costs associated with using CCP facilities.

[32] Discussion Paper at 20-21, paragraph 75.

[33] *Id*. at 17, paragraph 66.

[34] *Id*. at 19-21, paragraphs 74 and 75. ESMA sets forth potential technical standards with respect to CCP disclosure of information and internal policies and procedures. In particular, ESMA considers that CCPs should disclose: (i) to the public all information necessary to explain whether and how it meets its legal obligations ensuring its sound and prudent operation, including information enumerated in the Discussion Paper; and (ii) to clearing members and to clients (when known by the CCP) all relevant information on the CCP's design and operations as well as on the rights and obligations of clearing members.

Record keeping (Article 27)[35]

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?

MFA agrees with ESMA that record keeping is an essential CCP obligation and is a useful tool to monitor clearing members and their clients' activities. However, it is critical that the mode by which CCPs maintain and make available their records ensures that CCPs store and transmit information securely. In particular, we believe that ESMA should require CCPs to develop and maintain systems, policies and procedures to protect the privacy and confidentiality of information, which will ensure that market participants utilize the services of CCPs with confidence. MFA's members invest heavily in their customized and proprietary investment strategies, which form the foundation of their businesses. As a result, to safeguard against disclosure of such positions, MFA's members will enter into confidentiality agreements with their counterparties. Therefore, it is essential that ESMA ensure that CCPs store and transmit records in a manner that is comparable to such arrangements.

Margins (Article 39)[36]

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?

MFA supports ESMA drafting technical standards, in consultation with CCPs, that provide CCPs with as much flexibility as possible in determining when, if ever, to apply a confidence interval above 99 per cent. CCPs have significant expertise, and thus, are the appropriate parties to establish additional margin requirements as part of their risk and default management procedures. Therefore, we encourage ESMA to engage with CCPs on a continuous basis to determine how to adapt margin requirements to particular instruments and to the markets as they develop over time. If ESMA does mandate additional margin requirements or use of a confidence interval over 99 per cent in its technical standards, we recommend that those technical standards allow CCPs to apply for exemptions from the rules for specific groups of

[35] *Id*. at 21-24, paragraphs 76 to 85. ESMA sets forth record keeping proposals for transaction records, positions and business records to comply with its EMIR requirement to draft technical standards specifying the records and information that CCPs must retain and their format.

[36] *Id*. at 25-28, paragraphs 92 to 101. ESMA sets forth various proposals with respect to the EMIR requirement that ESMA define: (i) the appropriate percentage above the minimum 99 per cent confidence interval that margins are required to cover for the different financial instruments; (ii) the liquidation period; and (iii) the lookback period. In defining the appropriate confidence interval percentage above 99 per cent, ESMA is considering the pros (*i.e.*, procyclicality, moral hazard, better capital treatment, portability and short history) and cons (*i.e.*, lower trading activity, management of a default and little justification for clearing member involvement in the CCP governance) for a higher confidence level.

derivatives in the event that market conditions prove that the application of the prescribed margin requirements is excessive.

As a general matter, we agree that it is necessary for CCPs to receive margin sufficient to cover the potential risks at such CCP. However, we note that imposing margin requirements that are excessive compared to risk exposure may damage market liquidity. MFA members respectfully request that ESMA consider current margin levels in the marketplace, and to the extent it proposes to require CCPs to use a confidence level higher than 99 per cent higher, provide some explanation for why such increased margin is necessary. We are not aware of any evidence that indicates that current margin levels are insufficient to protect CCPs or the markets. During the financial crisis, a significant issue was that certain parties did not post any margin when their counterparties should have required them to do so (*i.e.*, the issue was not that margin levels of those market participants posting it were insufficient), whereas MFA members post both initial and variation margin during the ordinary course of their business.[37]

In addition, MFA respectfully requests that in developing the technical standards, ESMA be mindful of the increased costs that high margin requirements may impose on clients. As a general matter, we support margin requirements that are risk-based and subject to regular review, as we believe that imposing margin requirements that are excessive relative to risk exposure adversely affect market liquidity and are inconsistent with a desire to move towards more central clearing.[38] Therefore, we encourage ESMA to adopt technical standards that remain flexible so that margin criteria can evolve with the markets.[39]

Review of models, stress testing and back testing (Article 46)[40]

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

MFA feels strongly that it is important that clients receive stress test results to ensure that clients have sufficient information to analyse CCPs properly. In addition, we believe that ESMA

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[37] *See* MFA's comment letter to the CFTC on its proposed rules on "Risk Management Requirements for Derivatives Clearing Organizations", dated March 21, 2011, available at: http://www.managedfunds.org/wp-content/uploads/2011/06/3.21.11-CFTC.DCO_.Risk_.Management.Rules_.Final_.MFA_.Letter.pdf, where we note that, during the financial crisis, many customers used far less leverage and were more creditworthy than many regulated entities.

[38] *Id.*

[39] For example, if ESMA incorporates a table in the technical standards that specifies the exact liquidation periods that apply, then ESMA should also build in flexibility to change the scope or provide exemptions where the application of the technical standards would prove to be excessive based on current market conditions.

[40] Discussion Paper at 41-43, paragraphs 153 to 156. ESMA proposes that a CCP should conduct stress tests to ensure sufficient coverage of its combination of margin, default fund contributions and other financial resources in extreme but plausible market conditions, and to validate its risk management model. ESMA also proposes to require CCPs periodically to report stress testing results and analysis to the Risk Committee and to make it available to all clearing members. ESMA also notes that while disclosing stress testing results and analysis to clients would provide for additional transparency, it could cause confidentiality issues to arise and that it will consider the conditions under which CCPs would need to disclose such information.

should require CCPs to disclose the methodology they apply and the data they use in stress testing, which will allow market participants to make better assessments of the relevant CCP's risk. Such disclosure will help to ensure that all market participants are in a position to assess risk and are able to utilize the services of CCPs with confidence. Thus, it is important that ESMA's technical standards are comprehensive in this regard in order to foreclose any loopholes that might prevent disclosure of necessary CCP data.

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

MFA agrees with ESMA's assessment that a CCP should, at minimum, publicly disclose: (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.[41] We believe that public disclosure of information is one of the key tools, which will enable market participants to identify risks and assess the appropriate margin. It is also important that ESMA require CCPs to have clear policies and procedures regarding what actions a CCP may take in a default scenario because we believe that there should be degree of certainty as to the process utilised by the CCP to work through the default of a clearing member. Default procedures should not only be clear and workable, but should also provide certainty to the clearing members and their clients as to their rights and obligations. In our view, such procedures would encourage markets that are more orderly in a time of likely market dislocation.

Transparency and data availability (Article 67)[42]

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?

Public dissemination of information is important for the purposes of promoting improved transparency in the markets, whereas limiting the availability of public data through the imposition of fees, subscription services or other barriers is unwarranted. MFA believes that the costs of implementing increased transparency requirements should be relatively low, and thus, we specifically recommend that ESMA require trading venues to publish daily aggregate weighted average and end-of-day price by instrument, based on actual transaction data as well as transaction volumes for all reasonably liquid traded instruments. ESMA should also require CCPs to publish free of charge end-of-day data including settlement prices, volumes and open

[41] *Id*. at 45, paragraph 162.

[42] *Id*. at 54-56, paragraphs 202 to 208. ESMA's proposed approach to transparency 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, authorities should receive information in an automated form.

positions. Consistent reporting would give market participants a broad and timely view of the market, which would be beneficial to central clearing and liquidity in the markets.

Although we support public dissemination of information, MFA reminds ESMA that it is critical that publication be on an anonymous basis. There will be situations where even aggregate disclosure will reveal the identity of the parties involved because, for example, an instrument is not frequently traded, not sufficiently liquid or is highly customized. The level of aggregation should be such as to prevent this inadvertent disclosure. In that vein, MFA strongly recommends that ESMA work to protect the confidentiality of counterparty identities by prohibiting trade repositories from publicly disseminating counterparty identification information, with appropriate exemptions for thinly traded or customized instruments. As mentioned herein, our members employ a customized and proprietary trading strategy, so disclosure of identifying information could result in disclosure of trading positions and strategy.

With respect to the frequency of public disclosure, MFA supports weekly, aggregated disclosure but recommends that ESMA establish disclosure timeframes tailored to specific products. We recommend that ESMA employ disclosure thresholds that are specific to each class or subclass of derivative, and are set at levels or ranges that do not threaten to reduce market liquidity. We would also note that ESMA should ensure that the disclosure requirements are adaptable so that the applicable thresholds and timeframes reflect changing liquidity levels in the market over time. Specifically, MFA recommends a phased approach that begins with longer timeframes, which reduce over time if concerns about liquidity do not materialise.

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MFA thanks ESMA for the opportunity to provide comments regarding the proposals in the Discussion Paper. We strongly support the efforts of ESMA to develop technical standards in response to the mandates given to it in EMIR. We would welcome the opportunity to discuss our views in greater detail. Please do not hesitate to contact Carlotta King or the undersigned at (202) 730-2600 with any questions ESMA or its staff might have regarding this letter.

Respectfully submitted,

/s/ Stuart J. Kaswell

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