



Paris, 9th July 2010

**ACI – The Financial Markets Association comments on  
EUROPEAN COMMISSION - Public Consultation on  
Derivatives and Market Infrastructure**

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A - Background :

ACI focuses historically on FX (Foreign Exchange) and Money-Markets and all their kind of Derivatives but our members also cover all segments of the financial markets such as Fixed Income, cash or derivatives, being OTC or in regulated markets.

Founded in 1955 and located in Paris our association regroups today 13,000 individual members from 64 countries worldwide - all of them being market specialists (mainly traders). ACI built up strong market practices summarized at 'The Model Code', becoming *The International Code of Conduct and Practice for the Financial Markets*. Additionally ACI certifies some 1,400 persons a year (mainly traders, mid- or back office staff) through its exams program (ACI Dealing Certificate, ACI Operations Certificate and ACI Diploma). ACI was a co-founder of the Euribor ACI in 1999 and still runs actively working groups focusing at Money Market and Liquidity, Derivatives, Short Term Papers and Foreign Exchange.

ACI's contribution and goal is to support regulators and authorities with the knowledge and expertise from its members being the traders in the markets.

For more details on our association please refer to our Web: [www.aciforex.org](http://www.aciforex.org)

B - Forex activity :

Our opinion on Forex (Foreign Exchange) markets is that CCP's would be counter-productive, as they would create an accrued cost of exchanging currencies while barely reducing the counterparty risk. The FX market is very short dated ( 81% is less that 7 days maturity ), and as CLS already covers 55% of the FX market, and 95% of all interbank settlements.

It will be critical to differentiate the interbank market with the corporate market, as companies need physical delivery of their currencies in the countries where they conduct their business, and therefore a CCP would be of no use for them. Imposing an "information threshold" could be a solution as proposed in the document, although it would have to be carefully calibrated to allow companies to hedge present or future flows as they do to mitigate their currency risk and

focus on their industrial objectives. Imposing new constraints on them will increase their hedging costs, potentially up to a point when they might prefer not to hedge, therefore increasing the risk rather than mitigating it.

This opinion is detailed in the EC public consultation paper (page 5 / 4.a. ).

**We therefore consider that the FX interbank market delivery risks are well covered by CLS, and that imposing CCPs to corporates would be counterproductive.**

For all other derivatives, our opinion is synthesized hereby :

### C – Questions of the Consultation Document :

#### **Section I paragraph 3.**

- Need for a distinction between market participants :

For most derivatives we think that collateralization, or clearing through a CCP are the best ways to mitigate risks. This applies to counterparties like banks, Funds, Financial Institutions, Asset Managers, who may have a number of trades offsetting each other, or which positions might pile-up and create a systemic risk for the industry.

For corporate the situation is different, as if the derivatives are used properly they mitigate the risk of the company on Forex, interest rate, commodities or credit and therefore have to be linked to the risk they hedge, rather than to another derivative.

It is crucial to take this point into account in the new legislation and to avoid imposing techniques designed for the financial world to the industrial one.

- Need for a distinction between markets :

Some derivatives are difficult to standardize, as a global agreement on their price could depend :

- On specific legal clauses present in the transaction that might affect its value
- On a different access to liquidity from market participants : especially for long-dated transactions, as the net present value of future flows depends on the discount curve, which itself reflects the access to liquidity of each counterparty, which could vary widely depending on their rating. Imposing a single price to such product will therefore contribute to "hide" the counterparty risk rather than mitigate it.
- Small size transactions which pose no risk to the market should be exempted

**For these reasons we think that clearing through CCPs should be optional and not mandatory : the market participants are the best judges of the adequacy between their positions and the clearing system.**

**The obligation to disclose the proportion of derivatives held by a counterparty that are cleared through a CCP will create a strong**

**incentive anyway, as the rating of the counterparty will be affected by this ratio.**

***Section I paragraph 4 b***

It is critical to differentiate Financial Institution from Corporate in the regulation, in order to prevent an additional ineffective burden on companies that only use derivatives to hedge.

Imposing an information threshold that would represent the "standard" amount of derivatives the company needs to hedge, and considering that any amount traded over this threshold would be a sign that the company is turning into a financial institution and adopting a more "speculative" profile might be a solution. But the determination of the threshold is complex, will depend on the company's business and also on the market conditions.

**It is a good idea but difficult to implement.**

***Section I paragraph 5 a and b :***

**Yes we think those 2 points should be mandatory for all market participants anyway.**

***Section II paragraphs 1,2,3,4,5,6***

Our remarks on these paragraphs :

- Importance to maintain a balance between regulatory improvements and the costs they imply : we suggest an impact assessment of the effect of higher clearing costs generated by the use of CCPs by Financial Institutions, and potential higher provisions for non-financial end users who rely on inventory.

- Address the potential conflicts of interests :

- Between the ESMA and the national supervisors who authorise and supervise the CCPs
- Between the national supervisors who push for a maximum of derivative contracts to be cleared, and the CCPs themselves, through their board and shareholders, who will be responsible for determining the maximum level of risk they are ready to take, which might imply refusing to clear some trades if they do not feel confident with them. They should have the last word on the trades they clear.
- As the CCPs will concentrate risks, they should also be considered as specific counterparties in times of crisis, and be entitled to whatever accrued liquidity is allocated in case of market stress.

## **Section II Paragraph 7**

**Yes we agree**

## **Section II Paragraph 8**

It is important to maintain the balance between the CCPs who have to contribute to the default fund and the counterparties who are members and who have to provide the margin calls. This is why the initial capital, as well as the procedures to follow in case of default of one of the counterparties to provide the additional margin call have to be well designed.

We fully agree with the points mentioned in F.

The initial capital and the default fund should depend on the risks taken by the CCPs, and measured by its VAR and stress tests under systems validated by the local regulator. Full disclosure of procedures and provisions in case of a default are obviously necessary. It is also obvious that regulators have to ensure that they have the means to analyse the data provided to them, and to confirm independently the stress results.

## **Section II Paragraph 9**

We think that it is important to make sure that the standards used are global and do not oblige the CCPs to subsidiarize in the EU, as it would create a double standard between CCPs and allow risk and geographical arbitrage between the 2 categories. Also the links between clearing houses ( detailed in II 7 c ) will exacerbate risk especially for CCPs not operating under the same standards. We feel it is less risky to have global pragmatic standards than specific regional ones.

## **Section III**

Interoperability requires global standards. The US is allowing all derivatives (except listed ones ) to be cleared in any CCP that can handle its risk, so creating double standards will be inefficient.

The EU settlement code of conduct will also have to be extended to the concerned derivatives.

## **Section IV**

Reporting and trade repository is essential.

We favour option 2, " recognition of third countries trade repositories", with the provisions mentioned ( ban of EMSA recognition if data are not provided ). The reason for this is this option prevents the creation of double standards that would blur the risk analysis of the same contract depending on where it is settled.

### ***Section IV 3***

**Yes we share the general approach on recording, transparency and data availability.**

*ACI The Financial Markets Association  
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