ČESKÁ BANKOVNÍ ASOCIACE

Set up in 1990, the Czech Banking Association (CBA) is the voice of the Czech banking sector. The CBA represents the interests of 37 banks operating in the Czech Republic: large and small, wholesale and retail institutions. The CBA is committed to supporting quality regulation and supervision and consequently the stability of the banking sector. It advocates free and fair competition and supports the banks' efforts to increase their efficiency and competitiveness.

We appreciate the opportunity to comment on Second Consultation Paper **DRAFT REGULATORY TECHNICAL STANDARDS ON RISK-MITIGATION TECHNIQUES FOR OTC-DERIVATIVE CONTRACTS NOT CLEARED BY A CCP UNDER ARTICLE 11(15) OF REGULATION (EU) NO 648/2012.** Our responses to questions in Joint Committee´s Consultation Paper are set out below.

Q1: Respondents are invited to comment on the proposal in this section concerning the treatment of non-financial counterparties domiciled outside the EU.

We agree that the risk profile of exposures to non-financial counterparties domiciled outside the EU should be treated in the same way as they were domiciled in the EU.

Q2: Respondents are invited to comment on the proposal in this section concerning the timing of calculation, call and delivery of initial and variation margins.

We do not share the opinion that daily exchange of margins is necessary. Especially in case of non-financial counterparties and in case of smaller financial counterparties it should be allowed that the parties may agree on other frequency of margin exchange (e.g. weekly frequency).

Q3: Respondents are invited to provide comments on whether the draft RTS might produce unintended consequences concerning the design or the implementation of initial margin models.

The initial margin models under the RTS should correspond to the models applied by the central counterparties in connection with centrally cleared derivatives. In other words, the initial margin models under the RTS should not be more demanding than those applicable by the central counterparties.

Q4: Respondents are invited to comment on whether the requirements of this section concerning the concentration limits address the concerns expressed on the previous proposal.

We are of the opinion that implementation of concentration limits for collateral is not justified and it is senseless. The idea of concentration limits is based on the expectation that default of counterparty may decrease the value of collateral (posted in the form of securities issued by a third party). However, this may happen only in extraordinary market circumstances, when the defaulting counterparty is a global systematically important bank (such as Lehman Brothers was). Only in such case may the collapse of one counterparty lead to depreciation of the collateral. Therefore, the implementation of concentration limits may by justifiable (if at all) only in case of counterparties which collapse may depreciate certain types of collateral. Defaults of a financial counterparty or non-financial counterparty usually do not lead to the collapse of markets and to the depreciation of collateral. The implementation of concentration limits is not justifiable in general.

Q5: Respondent to this consultation are invited to highlight their concerns on the requirements on trading relationship documentation.

We do not believe that it is necessary that the annual legal review of enforceability of netting arrangements must be “independent”. We are of the opinion that also an internal assessment should be sufficient and also the annual frequency seems to be too demanding and not necessary. In addition, the legal enforceability of netting agreements within the EU should be ensured by the adoption of the long-discussed draft Netting Directive.

Q6: Respondents are invited to comment on the requirements of this section concerning the legal basis for the compliance.

We strongly disagree with the requirement that an annual independent legal review must verify that the segregation arrangements meet the requirements under the RTS. This will cause additional costs and administrative burden. In addition we do not believe that it is necessary that the annual legal review must be “independent”. We are of the opinion that also an internal assessment should be sufficient. Also the annual frequency seems to be too demanding and not necessary.

In addition, we are of the opinion that the EU should implement laws (directives, or regulations) which will ensure that the segregation arrangements regarding initial margin are legally enforceable. It is a strange situation when the lawmaker requires from the addressees of the law that they are obliged to ensure the legal enforceability of requirements set by the lawmaker. Such obligation may be imposed in connection with jurisdictions outside the EU, but in connection with jurisdictions within the EU this should be ensured by the law (i.e. the EU law should ensure that the segregation arrangements regarding initial margin are legally enforceable within the EU; similarly like the Directive on Financial Collateral Arrangements ensures today that the financial collateral arrangements are legally enforceable throughout the EU). Until such laws are adopted within the EU it is not justifiable to impose this requirement on the market participants.

Q7: Does this approach address the concerns on the use of cash for initial margin?

We are of the opinion that regarding cash margin no segregation requirements should apply at all.

Q8: Respondents are invited to comment on the requirements of this section concerning treatment of FX mismatch between collateral and OTC derivatives.

We are of the opinion that it is not necessary to apply additional haircuts in such situations and the respective counterparties may agree whether they apply such additional haircuts, or not.

Our further remarks/questions

Is there any ITS expected to specify certain parts of RTS in more detail? For example regarding the calibration of Initial Margin models (Section 4, Art. 3) there are stated several conditions imposed on the quality of historical data to be used such as:

- the time series (min. 3 and max. 5 years long) shall be from the most recent continuous period
- the time series shall contain at least 25% of "stressed data" and if this type of data is not included "naturally", some part of the time series should be replaced by "stressed data" which should make at least 25% of the adjusted time series

Q i: Is there any specification expected on which data is already "stressed data" and which one is still considered as usual? E.g. specification like that it should be data only from periods when the volatility was at least x % etc.

Q ii: Is there any specification expected on the replacement methodology if the time series is not stressful enough and requires an additional "stressed data"? A bank can optimize its approach when introducing new "stressed data" in the time series (e.g. to replace some relatively more turbulent parts of the time series instead of the less volatile ones). Will be this optimization acceptable for the models?

We hope that our response to the Second Consultation Paper is sufficiently clear and our views are helpful for finalizing the regulatory technical standards.