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Opinion

Title

DG MARKT - Impact Assessment on: Proposal for a Regulation on the OTC Derivatives Market and on Post-trading Market Infrastructure

(draft version of 12 may 2010)

(A) Context

The financial crisis highlighted a set of shortcomings in the working of the markets for over-the-counter (OTC) derivatives. In response, the Commission fostered new commitments by major dealers for the centralised clearing of European-referenced credit default swaps (CDS) while advancing reflections on less urgent policy measures – see Communications Com(2009)114 and Com(2009)563. Reflecting Council conclusions (notably on 2 December 2009) and in line with the agreements reached within the G-20, the Commission is now planning to come forward with a first set of measures linked to the use and regulation of post-trading market infrastructure in the field of derivatives.

(B) Overall assessment

The Board notes that the draft regulation envisages further implementing measures or forthcoming initiatives to determine essential issues such as the identification of the contracts to be cleared centrally, the increase in capital requirements for bilateral clearing and the thresholds for including non-financial enterprises. As a result, the final impacts of the proposed legislation, while potentially significant, are difficult to assess at this stage, and this draft report focuses on a high level description of possible processes. Against this background, the Board finds that the level of analysis in the report is generally proportionate, but considers that it should discuss alternative high level options on the level of detail to be determined by this regulation or by further implementing measures. The report should also systematically flag the issues to be determined at a later stage and clarify the process through which the alternative options and their impacts would be analysed. In addition, it should improve the assessment of some of the options in this report, the qualitative discussion of overall impacts and the analysis of international aspects. Finally, the results of the on-going public consultation should be integrated in the report. Should this imply significant changes, the report should be resubmitted.

Given that future implementing measures to define details are likely to have significant impacts, the Board underlines the importance of ensuring that they will be subject to full impact assessment analysis.

(C) Main recommendations for improvements

(1) Explain fully which issues are covered by the current impact assessment and the related proposal, and which will be covered by future initiatives. To justify the approach chosen, the report should include a discussion of whether alternative approaches for the level of detail to be determined by this regulation or by further implementing measures were analysed and not considered appropriate: for example fixing key parameters in this regulation or specifying further the principles which should be followed when establishing them. The options presented in the report are generally of a high level nature and the analysis of their impacts broad and qualitative in nature. When this results from the above choices as, for instance, for eligibility for central clearing and various thresholds levels, the report should clearly say so and explain how these details will be determined and their impacts assessed. In all other cases, and notably for interoperability of central clearing parties, the report should make a further effort to explain the underlying issues, specify the options available and identify their impacts.

(2) Improve the assessment of some options. The report should explain more clearly the reasons for the rejection of mandatory central clearing for all derivatives as well as of the industry's own initiatives, for instance by providing information about the coverage of these initiatives in different markets. The assessment of the effectiveness and proportionality of the options to increase the use of central clearing should explicitly take into account the expected impact of the planned changes in the capital requirements directive.

(3) Strengthen the analysis of impacts. The report should improve the assessment of the broad economic impacts of the proposal. In particular, it should discuss more fully the expected distribution of the likely increase in the cost of credit across stakeholders, the implications of different timelines for implementation and the likely changes in overall costs across different options, notably by assessing the potential for cost savings under the options envisaging greater centralisation. It should make clear when lack of data provided by industry or methodological difficulties have hampered the estimation of costs and/or benefits. The report should also summarise how the envisaged set of measures is expected to lead to macroeconomic benefits by mitigating various types of risk.

(4) Expand the analysis of international aspects. Given the international character of the derivatives market, the report should analyze any particular challenge raised by post-trade infrastructure which is not located in the EU, the possibility of trading across jurisdictions and possible divergent regulatory provisions on the relevant markets, in particular given the potentially different scope of the US approach. In this context, the report should give a broad idea of the risks created by these international issues and clarify the extent to which the underlying proposal addresses these risks.

Some more technical comments have been transmitted directly to the author DG and are expected to be incorporated in the final version of the impact assessment report.

(D) Procedure and presentation

A second public consultation was on-going at the time of the Board review. Its results should be integrated into the report. The report largely exceeds the 30-page limit. While this is partly justified by the complexity of the issue, the report could be shortened considerably even after integrating the changes suggested above. An annex summarizing the results of the consultations should be added.

(E) IAB scrutiny process

Reference number	2009/MARKT/072
External expertise used	No
Date of Board Meeting	16 June 2010