

Milan ŠTĚCH
President of the Senate of the Parliament
of the Czech Republic
Vladštejnské náměstí 17/4
CZ-118 01 PRAGUE 1

Brussels, 13 AVR. 2011
C/2011/2496

Dear President

Let me thank you for your letter dated 26 January 2011 accompanying the opinion of the Czech Senate on the Proposal for a Regulation of the European Parliament and the Council on OTC Derivatives, central counterparties and trade repositories {COM(2010)484}.

The Commission is pleased to note the Senate's overall support for our proposal to mandate the clearing of standardised OTC derivatives on a CCP and require counterparties to report OTC derivatives to trade repositories.

The first concern expressed in your opinion is that the proposed Regulation would hamper the use of tailor-made derivatives. In this context, the Commission would like to emphasise that although the proposed Regulation aims to mitigate the systemic risk of bespoke products by increasing standardisation and transparency, it does not aim at eliminating bespoke products. The Commission recognises that market participants looking to hedge a specific risk may not always find a standardised product that would effectively match their exposure and instead may prefer to use a bespoke product.

The opinion of the Senate also indicates that foreign exchange and interest rates derivatives do not pose systemic risk and should therefore not be eligible for mandatory clearing. Concerning this aspect, the Commission would like to stress that interest rates and foreign exchange are the two largest asset classes with respectively 73% and 8% of notional amount outstanding of OTC derivatives¹. On that basis, the Commission believes that these classes of derivatives do represent a systemic risk and should be within the scope of the proposed Regulation.

Furthermore, the opinion states that small financial institutions without systemic importance should not be subject to the clearing obligation and that retail banks should not have to clear the derivatives they use to manage risks arising from their banking activities. Although the Commission agrees that there are costs associated with posting collateral, it believes that this is essential to reduce counterparty risk and ensure the stability of the financial system. An exemption for small financial institutions or for retail banks hedging their risks would be an inappropriate solution. Small financial institutions are financial institutions that are highly interconnected and the Commission is therefore convinced that they should be treated as any other financial institution. Moreover, any attempt to define a "retail bank" or a "small financial institution" would be very complex and create obvious risks of loopholes and circumventions.

¹ Source: BIS

The Commission takes note of the concern expressed by the Czech Senate as regards the fact that certain aspects of the Regulation shall be adopted at a later stage, by means of delegated acts. Whilst understanding this concern, the Commission should like to recall that the possibility for the co-legislators to empower the Commission to adopt delegated acts is explicitly foreseen by the EU Treaties. In the case at hand, due to the technical complexity of certain issues relating to central clearing and the structure of central counterparties, as well as the need for flexibility in order to allow adjustments to market developments, the Commission believes that the proposed areas for delegated acts are justified and appropriate.

I hope that these explanations address the comments raised in the Opinion of the Czech Senate.

Yours faithfully,