



Oktober 2009
AK Position Paper

Communication of the European Commission
Ensuring efficient, safe and sound derivatives
markets (SEK (2009) 905)

About us

The Federal Chamber of Labour is by law representing the interests of about 3.2 million employees and consumers in Austria. It acts for the interests of its members in fields of social, educational, economical and consumer issues both, on the national and on the EU-level in Brussels. Furthermore the Austrian Federal Chamber of Labour is a part of the Austrian social partnership.

The AK EUROPA office in Brussels was established in 1991 to bring forward the interests of all its members directly vis-à-vis the European Institutions.

Organisation and Tasks of the Austrian Federal Chamber of Labour

The Austrian Federal Chamber of Labour is the umbrella organisation of the nine regional Chambers of Labour in Austria, which have together the statutory mandate to represent the interests of their members.

The Chambers of Labour provide their members a broad range of services, including for instance advice on matters of labour law, consumer rights, social insurance and educational matters.

More than three quarters of the 2 million member-consultations carried out each year concern labour, social insurance and insolvency law. Furthermore the Austrian Federal Chamber of Labour makes use of its vested right to state its opinion in the legislation process of the European Union and in Austria in order to shape the interests of the employees and consumers towards the legislator.

All Austrian employees are subject to compulsory membership. The member fee is determined by law and is amounting to 0.5% of the members' gross wages or salaries (up to the social security payroll tax cap maximum). 560.000 – amongst others unemployed, persons on maternity (paternity) leave, community and military service – of the 3.2 million members are exempt from subscription payment, but are entitled to all services provided by the Austrian Federal Chambers of Labour.

Herbert Tumpel
President

Werner Muhm
Director

Executive Summary

AK is greatly concerned about the developments on the financial markets, which have a serious impact on the real economy and thereby on the workforce. It holds the view that regulation measures including the ban of certain products are urgently needed at European level to gain control of the economic crisis. AK and the European Commission (EC) are of the opinion that the comprehensive granting of financial assistance will only then succeed in building trust when the cause of the crisis is analysed and steered into the right regulatory channels.

The Communication is thereby a first approach, which together with measures (regulation of hedge funds, strict state aid rules) has to be implemented.

The AK position in detail

The AK welcomes in general the initiative of the European Commission to introduce mandatory trading structures for the derivatives market at European level.

AK welcomes the initiative of the European Commission to introduce mandatory trading and post trading structures for the derivatives market at European level. This conforms to the declarations of the global financial summit of the G 20, which determined that no financial product should remain unregulated and without supervision.

Thereby in our opinion the representational Communication does not go far enough as due to the long-term detrimental effects derivative transactions, which until now have almost exclusively been carried out by way of bilateral clearing require more courageous regulations:

It must be standard that the **entire mandatory trading procedure** is carried out on an organized trading venue via a European Central Counter Party, CCP. Without such an obligation, the introduction of a Central Counter Party Clearing Agency could result in the fact that even more than before preferably non-standardised derivatives with bilateral Clearing could be traded Over-the-Counter, OTC.

The DG Internal Market has also noticed that in contrast to trading at derivative markets, the growth of Over-the-Counter trading with derivatives has rapidly increased (from \$ 80 billion to auf \$ 700 billion in the period 1998 to 2007), whereby this trade in

spite of the financial crisis had hardly decreased by December 2008 (2008: \$ 600 billion). Based on the statistics included in the Communication, the regulation of Credit Default Swaps, which showed a share of \$ 418 billion on the OTC market in 2008, seems to be most urgent.

In its analysis under Item 2.3 of the Communication, the DG Internal Market itself already shows the extreme weaknesses of the OTC market, in particular the difficulty in assessing the default risk due to the total intransparency of this market. From the point of view of AK, one has to conclude in view of the current, crisis that the OTC market is not suited to this kind of transactions. This is added by the fact that the liability position of some financial institutions (the most important OTC derivative traders) can be removed with information advantage to the disadvantage and at the expense of other market participants.

In the opinion of AK, setting up a Central Counter Party Clearing Agency, which is based in Europe, is essential for establishing a sensible network with national supervisory bodies including mutual information duties and rights. Any possible higher costs to be incurred by the market participants for making trading safer, is justified by the public interest in a functioning financial market.

From the point of view of the AK, the consideration of the European Commission, to wait for the initiatives of the financial industry to submit itself voluntarily to various CCPs, is not a practical alternative.

Apart from that it should be the aim at European level, to handle the **entire** derivatives trade, in particular Credit Default Swaps, within the scope of a European CCP. It would also be worth considering to declare derivatives, which do not fulfil the liquidity and standardisation requirements, as not tradable or to make trading them unattractive through control measures.

On the other hand, from the point of view of AK, the consideration of the European Commission, to wait for the initiatives of the financial industry to submit itself voluntarily to various CCPs, is not a practical alternative. The **CCP must be an independent institution, which is subject to public control**. The persistence of the crisis and the establishment of national subvention programmes mean that the continuation of such efforts has lost its impetus. This also results from the representational Communication, according to which to date no solution for the restructuring of obligations at the occurrence of a credit event has been submitted by the financial industry.

AK also welcomes the plan to standardise all OTC derivatives as possible.

On the issues raised by the Director General Internal Market in the Annex of the representational Communication in detail:

Standardisation

It must basically be stated that standardisation serves the protection of the public interest in the security and trustworthiness of the financial market both

for the user and for the real economy. This takes definitely priority over protecting the confidentiality of individual financial institutions or contracting partners. Seen from this aspect, AK concludes the following:

(1) What would be a valid reason not to use electronic means as a tool for contracts standardisation?

Electronic devices are basically suitable as means for the contracts standardisation, whereby data protection problems must take second place.

(2) Should contracts standardisation be measured by the level of process automation?

What other indicators can be used?

The number of completed transactions on the basis of standardised products could serve as other indicators of standardisation progress.

(3) Should non-standardised contracts face higher capital charges for operational risk?

Yes, higher capital charges should definitely be imposed on non-standardised contracts provided the use of non-standardised contracts is not prohibited in any case.

(4) What other incentives toward standardisation could be used, especially for non-credit institutions?

The best motivation for non-financial institutes is probably the obligation only to sell standardised products.

The AK argues for reasons of equal competition that no data should be exempt from being collected in a data repository.

Otherwise control measures, such as higher taxation, higher charges or higher risk participation of the non-financial institute could be considered.

Strengthening of the management in case of bilateral additional security measures

(5) How could the coverage of collateralised credit exposures be improved?

The risk coverage of credits with additional security measures should in accordance with the considerations of the DG Internal Market also be handled via the “Central Counter Party Clearing Agency”. According to this, the entire chain of counter parties would be transparent and the risk of the claim on which the safety agreement is based would be evaluated regularly as this is already the case for all credit insurance agreements.

(6) Are there markets where daily valuation, exchange of collateral and portfolio reconciliation cannot be the goal? Please justify.

From our point of view, it should be the aim – for the purpose of preventing unfair competition alone – to achieve the daily processing and evaluation for all security agreements.

(7) How frequently should multilateral netting be used?

No comment

(8) Should bilateral collateral management be left to self-regulatory initiatives or does it need to be incentivised by

appropriate legislative instruments?

As experiences have shown, the expectation to redress a grievance through self-regulating initiatives by the affected sector has been frustrated, or at least far more patience is needed. As the extent of the financial crisis and its impact on the real economy does not allow for waiting any longer, suitable legal initiatives have to be taken. In particular the market for security agreements has to be subjected to supervision and regulation, which corresponds to the “primary market” for loans granted.

Central data repository

(9) Are there market segments for which a central data repository is not necessary or desirable?

For reasons of equal competition no data should be exempt from being collected in such a data repository.

(10) Which regulatory requirements should central data repositories be subject to?

The requirement for the complete acquisition of data to create transparency is an adequate legal obligation to register the relevant data.

(11) What information should be disclosed to the public?

Basically all information should be available for publication, which is required for evaluating the credit-worthiness of contracting partners who are involved in a security agreement for a

The AK emphasises that the assessment of the suitability of contracts for the derivatives trade can be left to the CCP, provided it is subject to appropriate supervision.

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risk as well as information concerning the underlying risk.

Central Counter Party Clearing Agency (CCP)

(12) Do you agree that the eligibility of contracts should be left to CCPs? Which governance arrangements might be necessary for this decision to be left to the CCPs' risk committees?

The assessment of the suitability of contracts for the derivatives trade can be left to the CCP, provided it is subject to appropriate supervision or that it has been assigned relevant executive rights.

(13) What additional benefits should the CCP provide to secure a broader use of its services?

Due to the fact that experience has shown that the initial "good conduct impetus" of the financial market participants decreases with the continuation of the crisis, any voluntary submission to the envisaged procedural regime of a CCP will probably remain just a pipe dream. In our point of view a relevant obligation has to be legally determined by imposing sanctions in case of non-adherence.

(14) Is the zero-risk weighting a sufficiently effective incentive for using CCPs across different market segments?

No comment

(15) Should additional requirements, such as appropriate account segrega-

tion, be introduced to apply the zero-risk weighting to indirect participants?

No comment

(16) Should bilateral clearing of CCP-eligible CDS be penalised and, if so, to what extent? Is there a need to extend regulatory incentives to clear through a CCP to other derivatives products?

Yes, a penalisation in form of skimming of excess profits appears to be the most suitable option. If a stabilisation of the financial market is a serious objective then all derivatives have to be traded via CCP on an organised trading venue; otherwise this will result in market distortions in favour of unregulated products, as it has already been the case during the current financial crisis.

(17) Under which conditions should exemptions be granted and by whom?

Exceptions can only be granted by a supervisory body within the scope of legally determined narrow criteria. They should only be permitted if the contracting partners can prove that the use of a standardised and regulated derivative product is not suitable for covering the concrete risk.

(18) What is the minimum acceptable ratio of CCP cleared/eligible contract? What is the maximum acceptable number of non-eligible contracts?

AK is of the opinion that the aim has to be to capture all derivatives agreements to avoid loopholes.

(19) What statistics need to be provided to regulators to make sure they have all the information necessary to perform their duties?

No comment

(20) How could European legislation help ensuring safety, soundness and a level playing field between CCPs?

Proposals for establishing a European CCP should be prepared at European level. Another requirement for product standardisation is the determination of suitable standards at European level.

Transparency requirements

(21) Should MiFID-type pre- and post-trade transparency rules be extended to non-equities products?

Yes.

(22) How should transaction reporting of OTC derivatives to competent authorities be envisaged? Should it be extended to all contracts or to certain categories? If so, which ones? Are there other means to ensure that the competent authorities receive the relevant information on OTC derivatives transactions?

When OTC transactions, i.e. trading outside an organised trading venue, are to be admitted then one has to provide for a regular reporting requirement as well as for the basic obligation to use standardised products. If there is an urgent suspicion that the reporting requirement had not or not prop-

erly been adhered to, the supervisory body must be provided with appropriate inspection rights. The obligation must cover all products.

(23) How should position reporting of derivatives to competent authorities be envisaged?

Should it be extended to all contracts or to certain categories? If so, which ones? Are there other means to ensure that the competent authorities receive the relevant information on the exposures to particular contracts?

The considerations on OTC trading apply equally to the OTC portfolio (position reporting). It must be made mandatory to report all products to the supervisory body.

Organised trading venue

(24) How can further trade flow be channelled through transparent and efficient trading venues? What would be the appropriate level of transparency (price, transaction, position) for the different derivatives markets?

In order to channel the trade flows in organised trade venues, the trade with – if possible – all derivative products should be regulated similar to the stock markets. Trading outside public trading venues should be made less attractive by appropriate control measures (taxes, risk premiums). Extended civil complaint options in case of OTC transactions in accordance with the strict requirements on customer information should be made available.

The AK points out that trading outside public trading venues should be made less attractive by appropriate control measures such as taxes or risk premiums.

In summary, from the point of view of AK, a regulation of the derivatives market should be determined as follows:

- Setting up an independent European “Central Counter Party Clearing Agency” with information rights and duties towards national supervisory bodies, which is subject to public control.
- Derivatives trade only on an organised trading venue (derivatives market), which fulfils certain minimum requirements (among others publication of prices and other trade-relevant information) via such a “Central Counter Party Clearing Agency”.
- Standardisation of all derivative products.

The AK asks for the standardisation of all derivative products.



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