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NetOTC™

JULY 10, 2015

The European Securities and Markets Authority

The European Banking Authority

The European Insurance and the Occupational Pensions Authority

Ladies and Gentlemen,

Second Consultation Paper ("CP") on 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 published by the European Securities and Markets Authority ("ESMA"), the European Banking Authority ("EBA"), the European Insurance and the Occupational Pensions Authority ("EIOPA", and together with ESMA and EBA, the European Supervisory Authorities, the "ESAs") on 10 June 2015.

NetOTC welcomes the opportunity to respond to the CP on the draft RTS.

Founded in July 2011 as an independent company, NetOTC's focus has been on the development of a new generation of risk management and mitigation solutions for the uncleared OTC derivatives market. NetOTC's solutions provide participants with the means to address the regulatory changes and challenges in a timely and cost effective manner, whilst delivering commercial value in the form of collateral and capital efficiency. Throughout our development, we have been committed to:

- Transforming processes and creating market efficiency for non-standardized OTC derivatives.
- Delivering increased transparency, robust default management processes and reduced systemic risk to the OTC derivatives market.

NetOTC has set out its responses to the ESA's questions in the Annex attached hereto.

Yours faithfully,

Andrew Rennie

Head of Risk, NetOTC

Annex 1

Please see below NetOTC's responses to the specific ESA Questions and associated matters:

> Explanatory text for consultation
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> Respondents to the first Consultation Paper commented that the requirement to assign every single trade to a specific asset class instead of calculating all the sensitivities to the relevant risk factors had two major drawbacks. First, the approach would have been more restrictive than the wording in the BCBS-IOSCO framework and, second, that this would have implied a substantial increase of the IM requirements. On the top of that, operational processes would need to change. In order to avoid unintended consequences and with the intention to preserve the overall principle of limiting the offset between well-defined asset classes, the ESAs are consulting on a new draft of the RTS that allows more flexibility in the modelling phase which at the same time uphold the principle in the BCBS-IOSCO framework.

Question 3. 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.

Answer: NetOTC welcomes the proposed change – the additional flexibility should allow a more straightforward initial margin calculation while still preserving resilience to post-default stress.

> Explanatory text for consultation
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> This Article aims to clarify the proposal of the First Consultation Paper concerning the identification of a reference currency for the calculation of the FX haircut under the standardized approach. As cash for VM is considered the pure settlement of a claim, this should not be subject to any haircut. Furthermore, VM and IM should be considered separately when identifying the reference currency for this purpose: the transfer currency is the most natural choice for the VM, the termination currency the most natural for IM. Where "transfer currency" and "termination currency" do not appear in a bilateral agreement, the FX haircut should apply to the entire collected collateral.

Question 8. Respondents are invited to comment on the requirements of this section concerning treatment of FX mismatch between collateral and OTC derivatives.

Answer:

While we understand the simplicity of a single "termination currency" approach, we are concerned about dis-incentivising real hedging of currency risk in the underlying OTC portfolio. To the extent that there are FX risk exposures in the underlying portfolio, there are two straightforward approaches to protecting against FX losses arising from the default of a counterparty:

i) Calculating the impact of stressed FX moves on the underlying portfolio and posting sufficient collateral to cover any losses at the appropriate quantile.
ii) Directly hedging the FX risk of the underlying OTC portfolio by posting collateral in the appropriate currency.

This second alternative has the advantage that it provides a direct hedge against losses that is model independent. Moreover, to the extent that the underlying portfolio has exposure to multiple currencies, it naturally encourages diversification of collateral.

If haircuts are imposed that dis-incentivise the posting of collateral in multiple currencies, economically rational hedging may be discouraged, worsening outcomes.

We ask that the wording allow the offset of FX risks between collateral and portfolio before haircuts against the termination currency are calculated.