REPORT

on derivatives markets: future policy actions (2010/2008(INI))

Committee on Economic and Monetary Affairs

Rapporteur: Werner Langen
## CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION</td>
<td>3</td>
</tr>
<tr>
<td>EXPLANATORY STATEMENT</td>
<td>12</td>
</tr>
<tr>
<td>OPINION OF THE COMMITTEE ON DEVELOPMENT</td>
<td>15</td>
</tr>
<tr>
<td>RESULT OF FINAL VOTE IN COMMITTEE</td>
<td>18</td>
</tr>
</tbody>
</table>
MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

on derivatives markets: future policy actions
(2010/2008(INI))

The European Parliament,


- having regard to the Commission communication entitled ‘European financial supervision’ (COM(2009)0252),

- having regard to the Commission proposal for a regulation on Community macroprudential oversight of the financial system and establishing a European Systemic Risk Board (COM(2009)0499),

- having regard to the Commission proposals amending the Capital Directives (2006/48/EC and 2006/49/EC),

- having regard to the Commission communication and recommendation on remuneration policies in the financial services sector (COM(2009)0211),

- having regard to its resolution of 23 September 2008 with recommendations to the Commission on hedge funds and private equity¹,

- having regard to the G20 decisions of 24 and 25 September 2009 in Pittsburgh, which stated that ‘all standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms’, and the national legislation on derivatives currently being formulated in Europe, the US and Asia,

- having regard to the work of the OTC Derivatives Regulators Forum to establish globally consistent data reporting standards for trade repositories,

- having regard to the CESR and ERGEG advice to the European Commission in the context of the Third Energy Package (Ref.: CESR/08-739, E08-FIS-07-04),

- having regard to Rule 48 of its Rules of Procedure,

- having regard to the report of the Committee on Economic and Monetary Affairs and the opinion of the Committee on Development (A7-0187/2010),

A. whereas, although derivative instruments can play a useful role in allowing the transfer of financial risks within an economy, they differ considerably depending on product type and underlying asset class with regard to risk, operational arrangements and market participants; and whereas the lack of transparency and regulation in the derivatives market

played an exacerbating role in the financial crises;

B. whereas in the future, too, firms need to be able to manage the risks inherent to their business in a targeted fashion, under their own responsibility and at comprehensible prices, and whereas, taking into account the specificities of small and medium enterprises with regard to bilateral derivatives, firms should be responsible for risk,

C. whereas the worldwide derivative trading volume has multiplied in the last decade and, as a result, the uncoupling of economic activities and financial market products has advanced considerably,

D. whereas the basis for international cooperation should be established in order to handle internationally traded derivatives so as to achieve international standards and information-sharing arrangements between CCPs as a minimum,

E. whereas, at the end of June 2009, notional amounts of all types of OTC contracts stood at US$605tn, gross market values, which provide a measure of market risk, at US$25trn and gross credit exposures, which take into account bilateral netting agreement, at US$3.7trn, and whereas, in a context of excessive leverage, an undercapitalised banking system and the losses resulting from structured finance assets, OTC derivatives have helped to make large market participants mutually dependent even when they are regulated entities.

F. whereas the huge growth in the trading volume over the past few years has led to an increased assumption of risk without actual investment in the underlying instrument and, consequently, to substantial leverage,

G. whereas some OTC derivatives have become increasingly complex and counterparty credit risk has not always been correctly assessed and priced, and whereas there are considerable weaknesses in how derivative markets are organised and a lack of transparency, which calls for further standardisation in the legal conditions and economic purpose of instruments;

H. whereas regulation of central counterparty clearing facilities (CCPs) must ensure non-discriminatory access by trading venues in order to ensure the fair and efficient functioning of markets,

I. whereas in OTC transactions the identity of the involved actors/parties and the size of their exposure are not clarified,

J. whereas many OTC derivatives markets, notably the credit default swap market, are subject to very high levels of concentration with a few major firms dominating the market,

K. whereas the recent events involving sovereign credit default swaps used by financial speculators led to unjustified high levels of several national spreads; whereas those events and practices highlighted the need for further market transparency and for enhanced European regulation vis-à-vis trading of credit default swaps, in particular those connected to sovereign debts,

L. whereas in order for trade repositories to play a central role in ensuring transparency for
supervisors in derivatives markets, supervisors must have unfettered access to relevant repository data, and repositories must consolidate position and trade data on a global basis by asset class,

M. whereas Parliament welcomes the Commission’s paradigm shift towards greater regulation of OTC derivatives markets, abandoning the prevailing view that derivatives need no further regulation, chiefly because they are used by experts and specialists; calls, therefore, for future legislation to secure not only transparency in the derivatives markets but also sound regulation,

N. whereas Europe must establish a comprehensive collateralisation strategy for derivatives markets which must take into account the unique situation of business end-users in contrast to major market participants and financial institutions,

O. whereas most derivatives used by non-financial end-users involve limited systemic risk taken individually, and for the most part serve merely to hedge real transactions, and whereas non-financial institutions are firms that do not come within the scope of the MiFID (non-MiFID firms), such as airlines, car manufacturers and commodity dealers, which have neither created a systemic risk for the financial markets nor been directly harmed by the financial crisis,

P. whereas resilient derivative markets require a comprehensive collateralisation policy encompassing both central and bilateral clearing arrangements,

Q. whereas non-financial small and medium-sized enterprises that use derivative instruments solely in the course of hedging their risk when conducting their principal business, should benefit from exemptions from clearing and collateralization concerning capital requirements, provided that the extent to which certain derivatives are used does not create systemic risk (subject to a requirement that the Commission should check this exemption regularly) and that the volume and nature of transactions are proportionate to, and appropriate for, the real risks faced by end users; whereas minimum standards must also be guaranteed as regards tailor-made contracts, in particular where the collateralisation of derivatives and capital requirements are concerned,

R. whereas OTC derivatives products need proportionate regulation when used by non-financial end-users, but whereas, as a minimum, the necessary detailed transaction data must be given to the trade repositories,

S. whereas credit default swaps (CDSs), which are financial insurance products, are currently traded without any proper regulation,

T. whereas the CESR and ERGEG advice to the European Commission in the context of the Third Energy Package (Ref.: CESR/08-739, E08-FIS-07-04) recommends the creation of a tailor-made market integrity and transparency framework for the electricity and gas markets,

U. whereas all the measures announced will involve close and comprehensive cooperation with the G20 countries and the US authorities in order to prevent regulatory arbitrage opportunities between countries wherever possible and to foster the exchange of
information,

V. whereas systemic risk associated with clearing houses requires robust regulatory and supervisory standards and unfettered real-time access to information on transactions for regulators,

W. whereas derivatives prices should correspond appropriately to risk and whereas the cost of the future market infrastructure should be borne by market participants,

X. whereas the latest dramatic rises in the sovereign bond yields of some Eurozone countries to unsustainable levels has exposed the problematic economic incentives involved in CDS contracts based on sovereign debt, and clearly shown the need to reinforce financial stability and market transparency by demanding full disclosure to regulators and supervisors and banning speculative CDS trades on sovereign debt;

Y. notes that all transactions in derivative products denominated in an EU currency, relating to an underlying EU entity and to which an EU financial institution is party should be cleared, when eligible, and reported in clearing houses and repositories located, authorized and supervised in the EU which are covered by European laws and data protection; notes that the upcoming new regulation should set clear criteria for assessing the equivalence of CCPs and repositories located in third countries for those trades not cleared or not reported in the EU;

1. Welcomes the Commission’s initiative for better regulation of derivatives, and in particular OTC derivatives with a view to reducing the impact of the risks in the OTC derivatives markets for the stability of financial markets as a whole, and backs the calls for legal standardisation of derivatives contracts (inter alia through regulatory incentives in the Capital Requirements Directive (CRD) regarding operational risk), the use of trade repositories and centralised data storage, the use and strengthening of central clearing houses and the use of organised trading venues;

2. Welcomes the recent work of the OTC Regulators Forum (ORF) in response to the call from the G20 for further action to increase the transparency and robustness of the OTC derivatives markets;

3. Calls for more transparency on pre-trade transactions for all instruments that qualify for the extensive use of organised trading venues as well as for increased post-trade trade transparency through reporting of all transactions to repositories, to the benefit of both regulators and investors;

4. Backs the call for the compulsory introduction of CCP clearing between financial institutions for all eligible derivative products with a view to ensuring better assessment of counterparty credit risk, and supports the objective that as many eligible derivative products as possible should be traded on organised markets; calls for provision of incentives that encourage the trading of eligible derivative products on trading venues regulated by MiFID, i.e. on regulated markets and multilateral trading facilities (MTFs); notes that one criterion for clearing eligibility must be liquidity;

5. Insists that, in future, derivative prices must better reflect risk and that the costs of the
future market infrastructure must be borne by market participants and not by taxpayers;

6. Considers that individually negotiated derivatives are required to hedge special risks and therefore opposes the compulsory standardisation of all derivatives;

7. Calls on the Commission to use a differentiated approach to the many types of derivative products available, taking account of differing risk profiles, the extent of usage for legitimate hedging purposes, and their role in the financial crisis;

8. Notes that, as regards regulation, a distinction must be made between derivatives used as a risk management tool for hedging a real underlying risk to which the user is exposed and derivatives used solely for speculation and believes that the making of this distinction is hampered by a shortage of information and specific figures regarding OTC transactions;

9. Calls on the Commission to look into ways of significantly reducing the overall volume of derivatives so that the volume is proportionate to the underlying securities in order to avoid a distortion of price signals, to reduce the risk to market integrity and to cut down systemic risk;

10. Considers it important to pay particular attention to corporate derivatives to which a financial institution is a counterparty in order to avoid abusing such contracts not as corporate risk but as financial market instruments;

11. Calls for risk management and transparency to be strengthened, as the key instruments for greater financial market certainty, without neglecting individual responsibility for taking on risk;

12. Notes that company-specific risks require tailor-made derivatives that can act as efficient risk management instruments adapted to individual needs;

13. Calls on the Commission to enhance bilateral risk management standards as part of the forthcoming legislation on central clearing;

14. Is of the opinion that, through clearing, collateral by adjusting capital requirements and through other regulatory tools counterparty credit risk can be reduced; supports the Commission in proposing higher capital requirements for financial institutions in the case of bilateral derivative contracts that are ineligible for central clearing, based on a risk-proportionate approach and taking into account the effects of netting, collateral, initial margin, daily portfolio reconciliations, daily margining, automated collateral movements and other bilateral counterparty risk management techniques in counterparty risk reduction;

15. Calls for derivatives that do not meet the requirements of IFRS 39 and were therefore not assessed by an auditor to be subject to central clearing by a CCP once they exceed a threshold to be determined by the Commission; calls, furthermore, for the purposes of ensuring a clearer distinction, for checks to be carried out involving the submission of an independent assessment of OTC derivative contracts by an auditor in order to ascertain whether a non-financial institution can continue to conclude bilateral contracts;
16. Calls on the Commission to give a strong role in the authorisation of European clearing houses to the European Securities and Markets Authority (ESMA) and considers it useful that they are supervised by this same Authority because, inter alia, there would be pooling of supervisory expertise in one body and because risk associated with a CCP will be cross-border;

17. Believes that the access of CCPs to central bank money effectively contributes to safety and integrity of clearing;

18. Insists that CCPs must not be organised wholly by users, that their risk management systems must not be in competition with each other, and that regulatory arrangements for clearing costs must be envisaged; calls on the Commission to address these concerns in its legislative proposal and to set governance and ownership rules for clearing houses, with regard inter alia to the independence of directors, membership and close supervision by regulators;

19. Notes that common technical standards relating to issues such as margin calculation and information exchange protocols will form an important part of ensuring fair and non-discriminatory access by authorised trading venues to CCPs; further notes that the Commission must pay close attention to the possible development of technological differences, discriminatory practices and work-flow barriers which are harmful to competition;

20. Calls for conduct-of-business and access rules governing CCPs to ensure non-discriminatory access by trading venues, with the issues to be addressed including discriminatory pricing practices;

21. Backs the introduction of repositories for all derivatives positions, ideally distinguished by asset class and regulated and supervised under ESMA direction; calls for binding procedural rules to be established to prevent distortions of competition and to ensure equal interpretation in the Member States and, furthermore, for ESMA to have supreme decision-making authority in disputes; calls for the Commission to ensure that national supervisory authorities have real-time access to granular data in repositories that relate to market participants based within their jurisdiction and to data that relate to potential systemic risk that might be built up in their jurisdiction, as well as access to aggregate data from all repositories including those held in repositories based in third countries; notes that the service provided by repositories should be priced transparently in light of their utility-like function;

22. Calls on the Commission to draw up reporting standards for all derivative products consistent with standards being elaborated at an international level, to ensure that they are communicated to central trade repositories, CCPs, exchanges and financial institutions, and to make the data accessible to the ESMA and national regulatory authorities and the ESRB when required;

23. Calls on the Commission to develop measures to ensure that regulators are able to set position limits to counter disproportionate price movements and speculative bubbles;

24. Asks the Commission to ensure in particular that the valuation of all derivatives that are
not traded on exchange is conducted in an independent and transparent way, avoiding conflicts of interest;

25. Considers careful clarification of all technical details to be necessary, in close cooperation with national regulators, in particular as regards standards and the distinction between financial-market products and non-financial-market products, and welcomes the fact that the Commission has already addressed this issue; calls on the Commission to involve the Council and Parliament at an early stage;

26. Backs the Commission in its plan to establish CCPs under agreed European standards, overseen by ESMA; and demands that key market participants should not have a controlling influence on the governance and risk management of the CCPs but should be included in the risk management board; takes the view that, additionally, mechanisms to make useful contributions to the risk management process should be proposed;

27. Insists on the need to have regulatory standards to ensure that CCPs remain resilient to a broader set of risks, including multiple participant failures, sudden sales of financial resources and rapid reduction in market liquidity;

28. Believes that the definition of derivative categories, the creation of CCPs, the transparency register, capital charges, the setting up of independent trading venues or use of existing exchanges, exemptions for SMEs and all technical details should be decided in close cooperation with national regulators, international institutions and the future European supervisory authority, the ESMA;

29. Calls, therefore, for clear rules of conduct and the necessary compulsory standards as regards the setting-up of CCPs (involvement of users) and the decision-making procedures and risk management systems used by them; supports the Commission in its intention to propose a regulation governing clearing houses;

30. Backs the Commission in its intention to provide exemptions and lower capital requirements for SMEs’ bilateral derivatives if an underlying risk is being hedged, derivatives are non-significant in the balance sheet of the SME and the derived position does not create systemic risks.;

31. Calls, as a matter of priority, for credit default swaps to be made subject to independent central clearing and for as many derivatives as possible to be settled centrally by CCPs; believes that individual types of derivative with cumulative risks should, if necessary, be authorised only conditionally or even, on a case-by-case basis, prohibited; takes the view that, in particular, sufficient capital and reserves should be required to cover CDS in the case of a credit event;

32. Calls on the Commission to urgently and thoroughly investigate levels of concentration in OTC derivatives markets, and in particular in the credit default swap, in order to ensure that there is no risk of market manipulation or conflict of interest;

33. Calls for the European Commission to come forward with appropriate legislative proposals to regulate financial transactions involving naked selling of derivatives in order to ensure financial stability and transparency of prices; takes the view that, pending that,
credit-default swaps (CDSs) should be processed through a European CCP in order to mitigate counterparty risks, increase transparency and reduce the overall risks;

34. Demands that CDS protection should be payable only upon production and proof of an underlying bond exposure and be limited to the amount of this exposure;

35. Is of the opinion that all financial derivatives that concern public finances in the EU (including sovereign debt of Members States and local administration balance sheets) must be standardised and traded on exchange or other regulated trading platforms in order to promote transparency of derivatives markets for the public;

36. Calls for a ban on CDS transactions with no underlying credit which are purely speculative transactions involving bets on credit defaults, thereby leading to an artificial rise in the cost of credit default insurance and, consequently, to increased systemic risks through actual credit defaults; calls, as a minimum, for longer holding periods in the case of short sales of securities and derivatives; calls on the Commission to consider upper risk limits for derivatives, particularly CDSs, and to agree on them with international partners;

37. Considers that the Commission should investigate the use of position limits to combat market manipulation, most particularly at the point when a contract is approaching expiry (‘squeezes’ and ‘corners’); notes that position limits should be viewed as dynamic regulatory tools rather than absolutes, and that they should be applied when necessary by national supervisors following guidelines set by ESMA;

38. Calls for any derivative position, whether taken by financial or non-financial institutions, above a certain threshold, to be specified by ESMA, to be centrally cleared by a CCP;

39. Calls for the planned regulation of derivatives to include rules relating to the banning of purely speculative trading in commodities and agricultural products, and the imposition of strict position limits especially with regard to their possible impact on the price of essential food commodities in developing countries and greenhouse gas emission allowances; calls for the ESMA and the competent authorities to be given the competence effectively to tackle dysfunctions in derivatives markets, e.g. by temporarily banning naked short selling of CDS or by requiring physical settlement of derivatives and by setting position limits in order to avoid undue concentration of dealers on some market segments;

40. Calls for any future legislative proposal on derivatives markets to follow a functional approach whereby similar activities are subject to the same or similar rules;

41. Underlines the need for European regulation of derivatives, and calls on the Commission to coordinate its actions with Europe’s partners as far as possible, in order to secure regulation which is as internationally consistent as possible and internationally coordinated; underlines the importance of avoiding regulatory arbitrage through inadequate coordination;

42. Calls for industry initiatives to be supported and their value acknowledged since they can, in some instances, be as appropriate as, and complementary to, legislative action.
43. Calls for a cohesive approach within Europe in order to leverage on each financial centre’s strengths and to take the opportunity offered by this crisis to move a step further in the integration and development of an efficient European financial market;

44. Welcomes the Commission’s intention to submit legislative proposals on clearing houses and trade repositories as early as mid-2010 and to discuss the technical details with all institutions at national and EU level, in particular the Council-Parliament legislative authority, at an early stage;

45. Welcomes the Commission’s intention to submit legislative proposals on CDSs;

46. Underlines the importance of reviewing regularly the effectiveness of the future legislation, in cooperation with all market participants, and of adapting these regulatory provisions where necessary;

47. Calls for implementation of this resolution as soon as possible;

48. Notes that not only in the case of trading commodities and agricultural products, but also in that of greenhouse gas emission allowances, it must be ensured that the market operates transparently and that speculation is curbed; calls in this regard for upper risk limits to be considered for individual products.

49. Instructs its President to forward this resolution to the Commission, the Council, the national regulatory authorities and the European Central Bank.
EXPLANATORY STATEMENT

Introduction

In two communications - dated 3 July 2009 (COM(2009)332 final) and 20 October 2009 (COM(2009)563 final) - the Commission has given its views on future policy actions to ensure efficient, safe and sound derivative markets. In the process, the Commission has stressed that derivatives play a useful role in the economy in that they are used to transfer risks inherent to economic activity from risk-averse economic agents to agents more willing to bear them. As the Commission has pointed up, over-the-counter (OTC) derivatives in particular have contributed to financial market turmoil by allowing leverage to increase and by making market participants more and more mutually dependent.

According to information from the Bank for International Settlements (BIS) in Basle in December 2009, the total volume of OTC derivatives in all categories amounted to US$ 605 tn, the notional amount outstanding for exchange-traded derivatives being US$ 425 tn. That volume has risen dramatically in the last decade. The need for - and the point of - such a ballooning of financial market products can rightly be called into question. In July 2009, accordingly, the Commission proposed four complementary tools to reduce the negative impact of OTC derivatives markets on financial market stability.

The proposed policy actions are based on the De Larosièrereport, the European Council conclusions of June 2009 and the G-20 decisions in the second half of 2009. Essentially, the Commission is proposing four policy action areas:

• further standardisation of derivative contracts;
• the use of trade repositories;
• greater use of central counterparty clearing houses (CCPs);
• greater use of organised trading venues.

The Commission makes reference to a general paradigm shift in what has been its financial market policy to date. It is seeking to break with the traditional view that derivatives require no more than light-touch regulation because they are used by experts, and to propose legislation which, in particular, will increase transparency and enable market participants to price risks properly. As a result, the proposed measures will shift derivative markets from OTC bilateral clearing and trading to more centralised clearing and trading.

Function and relevance of derivatives

Derivatives are financial contracts with a value derived from what is termed an ‘underlying’, e.g. a commodity price, a share price or an interest rate, which, when a predefined event occurs, give a contractual partner a payment or a right to buy or sell. In the past, derivatives were used by financial institutions and firms (non-financial institutions) for hedging or for speculation purposes. Futures, credit default swaps (CDS), options and certificates are common derivatives. CDS provide for a compensatory payment in the event of credit defaults. Since the start of the financial market crisis - according to BIS documents - particularly speculative CDS derivatives have declined by comparison with previous years. At the end of
June 2009, the notional outstanding value of CDS contracts was US$ 36 tn. Increased netting of positions by market participants, particularly by key traders, has played a considerable role in this. Unlike the notional value of contracts between financial institutions, which has declined, the notional outstanding value for contracts between traders and non-financial customers has more than doubled. Overall, it can be concluded that derivatives are used either to manage a bank’s market risk or for trading purposes; they are designated as financial instruments held at fair value through profit and loss, and are initially included in the balance sheet on a trade date basis at cost. The subsequent accrual of interest and amortisation of premiums paid and discounts received are included in ‘interest income’ on an effective interest rate basis. After trade date, derivatives are revalued to fair value.

Assessment of the Commission’s proposals

The aims of the Commission proposals:
• to reduce default risk,
• to reduce operational risk,
• to increase transparency and
• to enhance market integrity and oversight
are shared by the rapporteur unreservedly. The individual provisions put forward to lay down common safety, regulation and operating standards for central counterparties, collateralisation for bilaterally cleared contracts, higher capital requirements for bilaterally cleared trades, and mandatory central clearing for standardised contracts through CCPs for financial institutions are among the proposals which should be supported. The overall regulatory framework also includes standardisation of contract terms and contract processing. To increase transparency, market participants would be obliged to report non-CCP-cleared positions and transactions to trade repositories, which, in turn, would be regulated and supervised. Trading at exchanges or at other organised trading venues would be made mandatory for standardised derivatives. The review of the Financial Market Directives for all derivative markets, including commodity derivatives, is to increase trading transparency. The Market Abuse Directive is to be amended to extend the scope of market manipulations to derivatives and enable regulatory authorities to set position limits.

Different treatment of corporate derivatives and bank derivatives

In energy or commodities trading - unlike on the financial market - a host of different firms are active. In addition to large market participants (energy utilities, large industrial consumers, oil companies, chemical firms, airlines and banks), there are smaller trading partners on the market, too, such as municipal utilities, distribution companies and independent energy traders.

Unlike pure financial market products traded between banks, corporate derivatives involve no major systemic risk for financial markets. Products traded on the financial market differ significantly from corporate products. While securities and financial instruments such as futures and options are traded on the financial market, the corporate derivatives market is often based on physical commodities, which determines price formation. The market price for those products is based on fundamental price-forming factors (such as, for example, power
plant capacity, weather, consumer behaviour, commodity availability and raw material prices) which are completely different from those on the financial market. In the case of corporate derivatives, no private investors are market participants.

With regard to pricing, transparency and counterparty credit risk, the distinction between mass market products and individual products is of great importance. In many instances, derivatives have been traded too cheaply because risk could not be correctly assessed. In the process, banks have systematically ignored risks or sold them on without sharing them.

**Distinctive feature of corporate derivatives**

Better and tougher regulation of derivative markets must take account of the special position of firms which have to continue hedging their financial and operating risks on favourable, tailor-made terms by means of derivatives. Using these financial instruments, non-financial firms hedge foreign-exchange, interest rate and commodity risks. Such non-speculative protection helps to create stability and growth for employment and investment. No noticeable deterioration in hedging corporate risks must be brought about as a result of the regulatory actions proposed. Though, in future, the pricing of derivatives must be more market-oriented, firms’ liquidity must not be constrained. As firms do not have the same access to liquidity as banks, providing excessive collateral may result in a markedly greater borrowing requirement, which must not overburden firms, in particular small and medium-sized enterprises. Since corporate derivatives - unlike financial institutions’ derivatives - have not been a major factor in the financial market crisis, a more discriminating view is imperative here.

**Conclusions from the Commission proposals**

The Commission proposals should be broadly supported. In addition, in the rapporteur’s view, particular attention should be paid to the following points:

• in future, the prices of derivatives must better reflect risk and the cost of the future market infrastructure must be borne by market participants alone and not by taxpayers;
• CCPs and their risk management systems must not be financed by users or be rivals;
• reporting standards must be laid down for all derivatives so as to ensure that they are communicated to central trade repositories;
• in particular for SMEs, exemptions and lower capital requirements must be allowed for bilateral derivatives;
• CDS derivatives must be subject to independent central clearing; and if necessary, where cumulative risks are involved, it must be possible to restrict them or, on a case-by-case basis, prohibit them;
• national regulatory authorities must be given access to trade repositories;
• responsibility for authorising CCPs in the European Union and third states should be given to the European Securities and Markets Authority (ESMA).

To optimise cooperation between national regulatory authorities and ESMA, gradual action is required.
28.4.2010

OPINION OF THE COMMITTEE ON DEVELOPMENT

for the Committee on Economic and Monetary Affairs

on derivatives markets: future policy actions
(2010/2008(INI))

Rapporteur: Eva Joly

SUGGESTIONS

The Committee on Development calls on the Committee on Economic and Monetary Affairs, as the committee responsible, to incorporate the following suggestions in its motion for a resolution:

A. whereas volatility has a devastating impact on the hungry poor in developing countries, who account for a considerable share of agricultural commodity producers and consumers worldwide and have no access to financial services or financial mechanisms to manage risks,

B. whereas according to studies by the FAO, the proportion of expenditure on food in a typical household budget revolves around 10 - 20% in an industrial country but amounts to between 60% and 80% in the least developed countries (LDCs),

C. whereas speculation on commodities that increases volatility in agricultural markets makes it more difficult to finance innovative investments for rebuilding domestic agricultural production in net food import-dependent countries,

1. While recognising the positive role of derivatives when they are used for hedging purposes, expresses concern about the adverse impact of the growing presence of financial investors in agricultural commodity markets, whereby institutional investors look at commodities as an alternative financial asset class to provide portfolio diversification;

2. Underlines that speculation on agricultural commodities affects the poor the hardest; recalls, in particular, that fluctuation of prices has negative macroeconomic effects for food importing countries, whose balance of payments deteriorates, and such fluctuation additionally worsens their level of indebtedness; recalls also that many developing and
least developed countries rely heavily on the export of raw materials or agricultural commodities to earn foreign exchange; takes the view therefore that unregulated trade in derivatives represents a serious threat to both security and agricultural production that needs to be addressed;

3. Urges the Commission to address the implications of commodity derivatives on food security, considering the steadily growing flow of speculative capital from financial investors into agricultural commodity markets;

4. Regrets that, given the non-transparency of existing data, it is difficult to examine precisely the direct link between speculation and commodity price development; points out, however, that the role of speculation in the commodity markets has been addressed by various bodies, including UNCTAD and the Permanent Subcommittee on Investigations of the United States Senate, and that they stress the negative role played by commodity index funds;

5. Points out that a considerable proportion of commodity producers are poor farmers with no access to sophisticated financial instruments to hedge against price volatility; recalls that supply management mechanisms are the best known tool to address excessive commodity price volatility, i.e. through international commodity agreements;

6. Calls on the Commission and the international donor community to expand investment in tools which have proven that they can enable poor farmers and communities in the developing world to manage and mitigate risk and volatility, while contributing to lasting food security, including community granaries, weather risk insurance and safety nets;

7. Regrets that there is currently no multilateral framework to respond to global speculation in food prices; takes the view that UN agencies should be granted authority to coordinate such a response; also takes the view that the EU should adopt stricter regulatory measures on commodity derivatives, including the introduction of a trade register permitting hedging and the clearing of all OTC transactions, while banning speculative activities such as short-selling or index derivatives.
## RESULT OF FINAL VOTE IN COMMITTEE

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<td><strong>Result of final vote</strong></td>
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<td><strong>Members present for the final vote</strong></td>
<td>Thijs Berman, Michael Cashman, Corina Crețu, Véronique De Keyser, Leonidas Donskis, Charles Goerens, Catherine Grèze, Enrique Guerrero Salom, Filip Kaczmarek, Franziska Keller, Gay Mitchell, David-Maria Sassoli, Alf Svensson, Eleni Theocharous, Patrice Tirolien, Anna Záborská, Iva Zanicchi, Gabriele Zimmer</td>
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<td><strong>Substitute(s) present for the final vote</strong></td>
<td>Proinsias De Rossa, Santiago Fisas Ayxela, Isabella Lövin, Emma McClarkin, Cristian Dan Preda</td>
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| Result of final vote | +: 43  
| | –: 1  
| | 0: 1  |
| Substitute(s) present for the final vote | Sophie Auconie, Elena Băsescu, Robert Goebbels, Arturs Krišjānis Kariņš, Philippe Lamberts, Gay Mitchell |