

## ICFR OTC DERIVATIVES FORUM – 4 MARCH 2010

# BIBLIOGRAPHY AND SELECTED DOCUMENTS

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In connection with the ICFR's Forum on Clearing and Settlement in relation to proposed OTC Derivative regulation, please find below a list of documents related to the questions that we have posed. Bear in mind that this list is not meant to be exhaustive but more designed to give a range of views as well as background information specifically in relation to the topics scheduled for discussion at this event. A more general bibliography relating to proposals on OTC Derivative regulatory reform can be found on the ICFR website ([click here to view](#)). If you have any difficulty accessing these documents please get in touch with Sarah Cottle ([sarah.cottle@icfr.org](mailto:sarah.cottle@icfr.org)).

If, when looking through this selected bibliography, you think of any documents which we have not included but which might be of use, please feel free to let us know and we can make sure that there are copies available on the day.

### **Documents on Proposed Regulation**

September 2009: FSA: Transaction Reporting User Pack  
(<http://www.fsa.gov.uk/pubs/other/trup.pdf>)

This guide sets out how the FSA requires transaction reporting to be carried out (this should be considered in light of potential trade reporting requirements under new US legislation). In particular, it discusses how OTC derivatives should be reported (section 7.2). This is limited to those OTC derivatives with a single underlying instrument admitted to trading on a regulated or prescribed market, and the FSA has explicitly stated that it feels that no other transaction reports are necessary as they do not aid in their fulfilling statutory objectives of market confidence and reduction of financial crime. Market participants have stated that CESR should be aware of this document before implementing similar procedures throughout Europe.

October 2009: European Commission: Summary of the consultation on: Possible Initiatives to Enhance the Resilience of OTC Derivative Markets  
([http://ec.europa.eu/internal\\_market/consultations/docs/2009/derivatives/summaryderivcons\\_en.pdf](http://ec.europa.eu/internal_market/consultations/docs/2009/derivatives/summaryderivcons_en.pdf))

This document summarises responses to the consultation carried out by the EC in relation to the OTC Derivatives market. It highlights comments from participants (including industry members, infrastructure providers and regulators) in relation to each question asked, both positive and negative. For example, although increased use of "electronic means" should on the whole be seen as a good thing, it should not be assumed that being able to use "electronic means" for confirmation and life cycle monitoring can be considered analogous to being capable of being cleared. Neither is process automation analogous to product standardisation. A number of respondents argued that the perceived increased risk of non-standardised trades is already priced into such trades, as a means of mitigating counterparty risk. Furthermore, the industry has already committed to more standardisation (see letters discussed below). Regarding data repositories, there were widespread concerns over confidentiality and transparency, as well as who would be required to provide the repository with such information. There was a general aversion to mandatory clearing; general agreement that there should be minimum standards for CCPs created, as well as the necessary legislation for the regulation of CCPs.

December 2009: FSA/HM Treasury: Reforming OTC Derivative Markets  
([http://www.fsa.gov.uk/pubs/other/reform\\_otc\\_derivatives.pdf](http://www.fsa.gov.uk/pubs/other/reform_otc_derivatives.pdf))

This document focuses on the FSA and HM Treasury's view of proposed US and EU legislation. It discusses the proposals at length and often comes to differing conclusions about the best way to reform regulation in this area. Significantly, the paper raises concerns about the risk involved in "over-standardisation" of products and the risk of mandating clearing of all standardised derivatives, as this "could lead to a situation where a CCP is required to clear a product that it is not able to risk manage adequately". There is a clear requirement for an increase in the robustness of counterparty risk, whether centrally cleared or not; there is a call for "consistent and high global standards for CCPs", as well as the general responsibility for counterparties "to bear the cost of mitigating their counterparty risk", whether using CCPs, collateral or capital charges. Furthermore, the paper clearly states that neither the FSA nor HM Treasury sees the requirement for the mandating of trading of standardised derivatives on organised trading platforms.

January 2010: Japanese FSA: Development of Institutional Frameworks Pertaining to Financial and Capital Markets (<http://www.fsa.go.jp/en/news/2010/20100122-3/01.pdf>)

This document sets out a number of recommendations for improvements to financial regulation in Japan as a result of the crisis. It ranges much wider than just discussion of how to deal with OTC derivative regulation, however, it also makes a number of suggestions in this area. It argues that there should be mandatory clearing of plain vanilla interest rate swaps and other derivative transactions of a certain turnover (for instance iTraxx Japan CDS index transactions), ideally in domestic CCPs. However, given the international nature of the transactions that Japanese institutions carry out, it also suggests forging alliances between domestic and international CCPs, thus increasing the number of CCPs that mandatory clearing can take place in. Any international CCPs would be subject to the same requirements as domestic CCPs. There should also be regulations on shareholdings in and the capital of CCPs. The new rules would require trade repositories, CCPs and the institutions themselves to give information on OTC derivative transactions to the J-FSA.

January 2010: EuroCCP: Recommendations for Reducing Risks Among Interoperating CCPs  
([http://www.euroccp.co.uk/docs/leadership/EuroCCP\\_InteroperatingCCPs.pdf](http://www.euroccp.co.uk/docs/leadership/EuroCCP_InteroperatingCCPs.pdf))

This discussion paper looks at the problem of interoperability of CCPs within Europe and the systemic risks posed to CCPs willing to undertake interoperability. This document has been published in advance of upcoming regulatory guidelines about how interoperability should work between some of the larger clearing houses in Europe. The recommendations to minimise systemic risk in this paper include requiring CCPs to augment their own default funds, and not the funds of other CCPs; neither should CCPs exchange margin. There needs to be a clear framework set out regarding regulation and risk management to ease the handling of problems in the future. Furthermore, commercial barriers should be removed (for instance, so that market participants do not have to connect to the clearer appointed to the trading venue), and there should be consideration, over the long-term, of inter-CCP netting, which ultimately could have the benefit of reducing liquidity and settlement risks.

January 2010: Federal Reserve Bank of New York Staff Reports: Policy Perspectives on OTC Derivatives Market Infrastructure ([http://www.newyorkfed.org/research/staff\\_reports/sr424.pdf](http://www.newyorkfed.org/research/staff_reports/sr424.pdf))

This paper sets out the New York Fed's proposals regarding OTC derivative regulation. It discusses the greater use of CCPs, and in doing so, highlights the success in doing this for the CDS market; the need to introduce mandatory reporting of non-clearable products to data repositories to aid

transparency both for regulators and the market; the use of exchanges and electronic trading platforms for those products that are sufficiently actively traded, and stronger operational and risk-management practices.

January 2010: CESR: Feedback Statement on the Consultation on “Classification and identification of OTC derivative instruments for the purpose of the exchange of transaction reports amongst CESR members” (<http://www.cesr.eu/index.php?docid=6478>)

This feedback paper documents the responses to CESR’s proposals on the classification and identification of OTC derivative instruments for use in transaction reports on TREM, the system implemented by CESR to facilitate the exchange of transaction reports amongst regulators. Whilst there was general approval regarding CESR’s suggestions, there was still a range of suggestions as to the means for classification and subsequent reporting. There was also a general view that any action taken must be done in light of the other reviews into the regulation of OTC derivatives markets. Respondents also highlighted the need to review the FSA’s Transaction Reporting User Pack in any attempts to produce pan-European guidelines in this area.

January 2010: CESR: Consultation on guidance to report transactions on OTC derivative instruments ([http://www.cesr.eu/data/document/09\\_768.pdf](http://www.cesr.eu/data/document/09_768.pdf))

**The deadline for responses to this Consultation Paper is 1 April 2010.** This consultation paper sets out further information about the information that CESR would expect to see in transaction reports for OTC derivatives. CESR points out that it is aware of the other initiatives around this that are currently underway, and as such, the proposals in this document may be subject to change. Furthermore, the guidelines – much like the FSA’s transaction reporting requirements in this area – only covers transaction reporting of OTC derivatives with a single underlying instrument on a regulated market. The primary driver for this reporting would be for the monitoring of market abuse, and not necessarily driven from other regulatory initiatives in this area.

February 2010: Singapore Exchange (SGX) announces consultation on the clearing and settlement of OTC derivatives (<http://www.sgx.com/wps/wcm/connect/b1602b8041893b8ba88eac433fed2ba3/Consultation+Paper+on+Proposed+Amendments+to+DC+Rule+6+02A+7+on+Re-novation+%2825-Feb10%29.pdf?MOD=AJPERES>)

SGX has published a consultation paper detailing proposed amendments to its derivative rules to provide the flexibility to accommodate physically deliverable contracts with varying delivery mechanisms and re-novation processes. Currently the re-novation process requires both matching of parties to a contract for the purposes of delivery and the posting of performance deposits (and, in some circumstances, the payment of the contract value). The proposals would see re-novation occur at such time, and with such conditions being met, in accordance with the relevant contract specifications. The proposals would also allow physically deliverable contracts with varying delivery mechanisms and renovation processes listed on the Singapore Commodity Exchange (SICOM) to be cleared through SGX.

February 2010: ISDA and EACT: Derivatives - Introduction to their uses, market structure and management of associated risks

A document put together by ISDA and EACT (the European Corporate Treasurers Association) on the uses of derivatives outside of the financial sector. It discusses risk management and the role that CCPs may play in this, as well as the market structure and the relationship between corporate activities and the financial services that may be involved in derivative transactions.

## **Speeches and Testimony**

October 2009: DTCC: General Counsel of DTCC's (Larry E. Thompson) testimony before the Committee on Financial Services hearing on "Improvements of Over-the-Counter Derivative Markets" ([http://www.dtcc.com/downloads/leadership/speeches/Congress\\_Testimony.pdf](http://www.dtcc.com/downloads/leadership/speeches/Congress_Testimony.pdf))

This testimony focuses on the benefits of having a single worldwide data repository for collating OTC trade information for those trades that are not eligible for CCP clearing. It would stand as a means of reducing the fragmentation of information, enabling regulators to gain a much more complete view. It must be borne in mind that DTCC's arguments are based on the fact that the single global repository would be their own Trade Information Warehouse (TIW), which currently acts as a repository for information regarding CDS contracts.

November 2009: Minutes of the fourth CESAME2 meeting ([http://ec.europa.eu/internal\\_market/financial-markets/docs/cesame2/meetings/20091020-report\\_en.pdf](http://ec.europa.eu/internal_market/financial-markets/docs/cesame2/meetings/20091020-report_en.pdf))

These minutes cover several topics outside the scope of this bibliography, but the discussion regarding derivatives suggests that the EC believe that there is no need for concern over regulatory arbitrage as regulators globally are working closely together. It also discusses the need to decide whether any future European CCP legislation will cover the current Code of Conduct, and states that there is no need for any trade repository to be located in the EU, provided "full and unfettered access" is feasible.

January 2010: CFTC: Remarks of Chairman Gary Gensler, OTC Derivatives Reform, American Bar Association, Committee on Derivatives and Futures Law (<http://www.cftc.gov/ucm/groups/public/@newsroom/documents/speechandtestimony/opagensler-26.pdf>)

This speech discusses the proposed regime in the US. Chairman Gensler is clear in his desire for all standardised products to be "moved into transparent trading venues and regulated clearinghouses"; "...all standardized transactions, regardless of whether they are between two Wall Street banks or between a bank and a corporation, should be subject to a trading requirement and a clearing requirement." He argues that this would serve to reduce "interconnectedness between Wall Street banks, their customers and the economy". This arguably goes against the exemptions that made it into the Bill as passed by the House of Representatives in December: he underlines this disagreement further by commenting that "an end-user [i.e. corporation] exemption could leave up to 60 percent of standardized transactions out of the transparency and clearing requirements". He continues that a key element in this reform is the ability to bring transparency not only to the regulators, but to the public as a whole, arguing that "the more transparent a marketplace is, the more competitive it is".

February 2010: Oral evidence given to the Treasury Select Committee's "Too Important to Fail?" Inquiry by Gerald Corrigan, Managing Director, Goldman Sachs USA (<http://www.publications.parliament.uk/pa/cm200910/cmselect/cmtreasy/uc261-iv/uc26102.htm>)

This testimony looks at much more than the open questions regarding OTC derivatives reform, however, there is discussion of derivative transactions carried out with sovereigns (in light of the deals carried out by Greece), and whether the transparency surrounding such deals was sufficient.

March 2010: CFTC: Remarks of Chairman Gary Gensler, OTC Derivatives Reform, Institute of International Bankers Washington Conference

<http://www.cftc.gov/ucm/groups/public/@newsroom/documents/speechandtestimony/opagensler-r-28.pdf>

This speech expands on Chairman Gensler's speech detailed above. He highlights three "critical components of reform": explicit regulation to lower risk (including capital and margin requirements, business conduct standards and recordkeeping requirements), enhanced transparency (through moving transactions to exchanges and other trading facilities), and a reduction in interconnectedness (through the introduction of central clearing). He goes on to discuss clearinghouse rules: they should have open access (so that there would be no discrimination between exchanges), open governance (to mitigate conflicts of interest) and open membership (to parties other than derivatives dealers). In terms of standardisation/eligibility, Chairman Gensler suggests that derivative dealers should not take a lead role in determining what is standardised/eligible, but that this should be done by clearinghouses and the SEC/CFTC, and that both regulators should retain regulatory responsibility for CCPs. Furthermore, both regulators should be given enhanced powers to require derivatives dealers to segregate counterparty margin from their own funds.

## **Letters**

March 2009: ISDA letter to Commissioner Charlie McCreevy (with industry signatories)

[http://ec.europa.eu/internal\\_market/financial-markets/docs/derivatives/2009\\_02\\_17\\_isda\\_letter\\_en.pdf](http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/2009_02_17_isda_letter_en.pdf)

Following a meeting of the Working Group on Derivatives on 10 December 2008, ISDA, along with several large derivative dealers, agree to use European-based CCPs, once ready, to clear CCP-eligible CDS on "European reference entities and indices based on these entities", and certainly no later than 31 July 2009.

June 2009: Several derivative dealers and buy-side institutions letter to William Dudley, President, Federal Reserve Bank of New York

<http://www.newyorkfed.org/newsevents/news/markets/2009/060209letter.pdf>

Several institutions (buy and sell side), write to the President of the New York Fed, detailing their commitment to the implementation of several important measures to reduce systemic risk, including engaging with CCPs to broaden the range of clearable products, increase customer access to CDS clearing solutions, improve industry governance, operational oversight and collateral management, all prior to the end of 2009.

September 2009: ISDA, SIFMA, LIBA: Response to EC Consultation on Enhancing OTC Derivatives Infrastructure (<http://www.isda.org/press/press090209.pdf>)

The industry bodies respond to the EC Consultation Paper, highlighting their concerns for process, and not product, uniformity; the need for CCPs to work with clearing members to determine the eligibility of products; the need for CCPs to be robust in operational and financial terms; the lack of support for financial disincentives for non-cleared products, but broad agreement in the need for collateralisation of interdealer OTC trades; and also agreement on the use of data repositories, provided that they do not stifle product innovation.

September 2009: G15 financial institutions letter to William C Dudley

<http://www.ny.frb.org/newsevents/news/markets/2009/ma090908c.pdf>

This letter sets out the performance targets set by the G15 financial institutions for the clearing of eligible interest rate derivatives and CDS by December and October 2009 respectively.

September 2009: ISDA document on the Treasury's Proposal Mandating Clearing of "Standardized" Swaps ([http://www.isda.org/c\\_and\\_a/pdf/ISDA-Mandated-Clearing-Standardized-Swaps.pdf](http://www.isda.org/c_and_a/pdf/ISDA-Mandated-Clearing-Standardized-Swaps.pdf))

ISDA sets out why initiatives to standardise the terms of all OTC swaps are counterproductive. This is primarily down to the inability to hedge effectively using standardised products, greatly increasing end-user basis risk. It also discusses how standardisation would affect clearing. It argues that standardisation is not sufficient for a product to become clearable; this requires several other factors, such as the frequency of trading in the contract, the liquidity being sufficient to aid price discovery and so on. It argues that the need and ability for clearing will depend upon the asset class, and where it has been possible, there have been market-led initiatives to push this through (as seen in the letters above). It argues that mandatory clearing of standardised products could actually increase risk, by replacing counterparty risk with credit, basis and liquidity risks.

March 2010: Several derivative dealers and buy-side institutions letter to William Dudley, President, Federal Reserve Bank of New York ([http://www.newyorkfed.org/newsevents/news/markets/2010/100301\\_letter.pdf](http://www.newyorkfed.org/newsevents/news/markets/2010/100301_letter.pdf))

This letter highlights the steps that have been taken to meet the goals set out in the June 2009 letter. While several goals set out in that letter have been met, there is still more work to do in terms of the provision and storage of data, increasing clearing-eligible products, standardisation of products where possible, collateralisation of bilateral transactions and operational performance. The targets set out in the letter are summarised here: [http://www.newyorkfed.org/newsevents/news/markets/2010/100301\\_table.pdf](http://www.newyorkfed.org/newsevents/news/markets/2010/100301_table.pdf).

### **Press Releases**

February 2010: SEC and FSA hold Fifth Meeting of the SEC-FSA Strategic Dialogue (<http://www.fsa.gov.uk/pages/Library/Communication/PR/2010/021.shtml>)

SEC chairman Mary Schapiro met with FSA Chairman Lord Turner and Chief Executive Hector Sants as part of the SEC-FSA strategic dialogue. In their meeting they discussed, amongst other things, market structure, particularly relating to central counterparties for OTC derivatives, and the need to review the existing Memorandum of Understanding to facilitate cooperation in this and other areas.

February 2010: CPSS-IOSCO: Review standards for payment, clearing and settlement systems (<http://www.bis.org/press/p100202.htm>)

The Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of IOSCO have launched a comprehensive review of their existing standards for financial market infrastructure such as payment systems, securities settlement systems and central counterparties. Their existing standards are set out in the *Core Principles for Systemically Important Payment Systems* (<http://www.bis.org/publ/cpss43.htm>), the *Recommendations for Securities Settlement Systems* (<http://www.bis.org/publ/cpss46.htm>), and the *Recommendations for Central Counterparties* (<http://www.bis.org/publ/cpss64.htm>). They aim to issue a draft of the revised standards for public consultation.

February 2010: SIX x-clear and LCH.Clearnet: Interoperability Summary  
([http://www.lchclearnet.com/media\\_centre/press\\_releases/2010-02-08.asp](http://www.lchclearnet.com/media_centre/press_releases/2010-02-08.asp))

Details a link agreement which provides the framework for successful interoperability across Europe; it is the same arrangement as between the LSE and SIX Swiss Exchange. The model has been designed to minimise the risk of contagion: key features include each CCP retaining the authority to determine the eligibility of trades for clearing, with margining processes that preserve the integrity and safeguards of each CCP.

February 2010: Tradeweb: Launch of derivalert.org to provide intelligence  
([http://www.tradeweb.com/about/news/press\\_releases/2010/02112010](http://www.tradeweb.com/about/news/press_releases/2010/02112010))

Tradeweb announces the launch of derivalert.org to provide essential news, commentary and insight on OTC derivatives reform.

### **News Articles**

January 2010: Risk.net: Number of OTC derivatives dealers could double after US reforms  
(<http://www.risk.net/risk-magazine/news/1586034/number-otc-derivatives-dealers-double-us-reforms>)

According to a new study by the TABB Group, the proposals may expand the field of major derivatives dealers in the US to 30 from 15 currently, due to the new risk controls lowering the barriers to entry. The requirements around clearing will enable smaller firms to enter the market, as well as a growth in “more nimble, and more technologically advanced” firms.

January 2010: Risk.net: US regulators demand more OTC derivatives data (<http://www.risk.net/risk-magazine/news/1586214/us-regulators-demand-otc-derivatives>)

During the initial session of the US Financial Crisis Inquiry Commission, regulators requested that more information be made available to them regarding OTC security-based swaps. Currently, the SEC cannot access information about security-based swaps without a subpoena. Requirements regarding reporting to data repositories will go a long way towards amending this.

January 2010: Reuters: CFTC wants big players to trade on exchanges  
(<http://www.reuters.com/article/idUSN2520432820100127>)

Chairman Gensler of the CFTC called for banks and other big players to trade derivatives on regulated exchanges as an “absolutely essential” part of regulatory reform. He suggested that doing so would “shift the information advantage from a small group of derivative dealers on Wall Street to the broader market”.

February 2010: Hedge Week: Corporations lack knowledge about OTC derivatives proposals  
(<http://www.hedgeweek.com/2010/02/04/33495/corporations-lack-knowledge-about-otc-derivatives-proposals>)

A survey by Greenwich Associates has shown that corporations and financial institutions are generally agreed that a move to centralised clearing would be an effective means of managing counterparty risk both at an individual level and market wide systemic risk. However, there are serious concerns about the lack of details around the proposals, how the reforms will impact overall

market liquidity and costs, and whether this will bring a lack of flexibility in the product types available.

February 2010: FT: Europe's post-trade dilemma (<http://www.ft.com/cms/s/0/1d536534-15aa-11df-ad7e-00144feab49a.html>)

This article discusses the relative expense of trading in Europe being a cause of post-trade (clearing and settlement) services. Full competition has not yet happened, meaning that clearing houses have largely stuck only to servicing those exchanges that they have a relationship with. As such, costs remain high and clearing is fragmented and inefficient. The process of interoperability, previously vaunted by European regulators, has ground to a halt in recent months, as there is no longer such an interest in fostering competition, particularly where (as here) it might engender risk.

February 2010: Reuters: 20 ways US House, Senate financial reforms differ (<http://www.reuters.com/article/idUSN1115379820100211>)

An overview of some of the main difference between the Bill that has been passed currently by the House of Representatives, and what the Senate wants of the Bill.

February 2010: Advanced Trading: E-trading: Missing Link to more efficient OTC Derivatives Space (<http://www.advancedtrading.com/derivatives/showArticle.jhtml;jsessionid=CI5AYQXO4OM1BQE1GHPCKHWATMY32JVN?articleID=222900052&requestid=35725>)

A study by the TABB Group suggests that the only way to make full use of any OTC derivative regulatory reform is through the incorporation by market participants of electronic front-to-back platforms for greater price transparency and efficient trade processing.

February 2010: Wall Street Journal: Greece Shows need for Derivatives Reform (<http://online.wsj.com/article/SB10001424052748704431404575066982745810158.html?mod=WSJ-hpp-LEFTWhatsNewsCollection>)

An article arguing that the Greece's trading in derivative products is a perfect argument for the need for more regulation in the OTC derivative market – particularly in relation to margin requirements. It argues that all swaps pricing and volumes should be made public, and that central clearing should be mandatory for nearly all OTC derivatives as it will ensure stricter margining requirements.

February 2010: Bloomberg: Fed Fails to Get Swap Users to Accept Clearinghouse Target (<http://www.bloomberg.com/apps/news?pid=20601103&sid=apYKJ4IXYnol>)

An article claiming that some of the biggest investors in credit default swaps oppose targets for clearing trades set by the New York Federal Reserve. Several asset managers and hedge funds will not agree to specific goals before the 1 March deadline to outline the industry's next steps to move swaps through to clearinghouses.

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