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13 May 2011

**Financial Stability Board report on OTC Derivatives Market Reforms Implementation:  
A response from the International Swaps and Derivatives Association (ISDA)**

**Introduction**

**ISDA welcomes the opportunity to respond to the Financial Stability Board's progress report on OTC derivatives market reforms that was published on 15 April 2011. The work of the FSB is vital to ensuring that regulatory reform is consistent across different regions, and we believe the report offers a valuable insight into the extent of international convergence. Below we respond to a number of issues raised in the report. Of these, the need to ensure regulatory consistency and a measured approach to achieving the 2012 G20 deadline are of particular importance. We hope that these observations prove useful and would be happy to assist with any queries on the points covered.**

**Regulatory consistency**

While some differences between jurisdictions in terms of detailed rules are inevitable given differences in market structure, we believe that a far greater degree of convergence is essential to the long-term health of the global financial system. We call on the FSB to discourage jurisdictions from introducing rules in a way that leads to gaps in oversight or to regulatory overlap, whereby particular markets and participants are subject to duplicative rules. Duplicative rules will raise costs, ultimately impacting the real economy, while not serving any regulatory goal. Areas of priority for achieving international consistency should include the scope of the clearing obligation, margin and collateral requirements, public transparency, capital requirements and the standards applied to central counterparties (CCPs).

We therefore appreciate the continuing efforts of the ODSG in support of international regulatory coordination. We also highlight that our ability to deliver on the commitments made in our letter to the ODSG of 31 March 2011 will be facilitated to the extent that regulatory requirements and the commitments made in that letter are consistent. A significant lack of consistency potentially risks inefficient allocation of resource and may lead to operational risk. If inconsistencies arise, the signatories and supervisors will revise the commitments as appropriate.

## **Reform timetable**

In terms of meeting the G20 commitments to reforming derivatives markets, we believe that the target of completing the legislative process by the end of 2012 should be achievable. However, to ensure that the transition to the new regime does not create instability or give rise to new risks, we believe that the implementation of new rules should not be rushed. It would be of benefit to industry and regulators to establish a roadmap setting out the timeframe for full implementation of the new regime, bearing in mind the fact that more comprehensive data from trade repositories will become available over the coming months and should be used to inform decisions about the order in which new rules are implemented.

## **Central clearing**

In its report, the FSB highlights the differences that are emerging between jurisdictions in central clearing, emphasising differences concerning the 'top-down' approach to determining whether a class of contracts is eligible to be centrally cleared. We do see a need for consistency in this area, and welcome further work by IOSCO on the international standards addressing central clearing. We emphasise, however, the need to consider not just the consistency of top-down approaches, but also the extent to which such approaches could lead to market uncertainty and even introduce systemic risk by forcing the central clearing of products that CCPs are not able to risk manage effectively. Avoiding such risk should form the basis for further consideration of the top-down approaches that are being introduced in different regions.

We also support the principle that the benefits of central clearing should be accessible to a broad range of market participants; we believe that this will help foster a level-playing field and maintain the supply of liquidity in the associated markets. Certain end-users, including non-financial entities, should be exempted from mandatory clearing given the nature of their involvement in the market. However, the principle of access should never be put above the need to ensure that CCPs are financially and operationally sound, particularly given the significant amount of risk that will be concentrated into CCPs. This calls for an approach to CCP governance, including design of the CCP risk committee and default arrangements, that serves to align the interests of clearing members and the CCP itself, and a risk-based approach to CCP capital charges. We would also highlight the importance of rules that facilitate an appropriate level of competition between different CCPs, something that is equally important from the end-user perspective. As with access, competition should not come at the expense of sound risk management.

We also believe that regulation should encourage an orderly transition to the new clearing environment, and welcome the increasing awareness of the risks associated with the pace of implementation in some jurisdictions. An appropriate degree of phasing in of clearing obligations will help prevent a liquidity crunch and will give end users more time to adapt their systems to accommodate the new regime. An approach that discourages the proliferation of local CCPs would also be welcome.

## **Organised trading of derivatives**

As far as the exchange-trading of derivatives contracts is concerned, we welcome IOSCO's contribution to this discussion and the conclusion that a flexible approach to defining what constitutes an organised platform would maximise the number of standardised derivatives products that can be appropriately traded on these venues. IOSCO's report also concluded that continuing to allow certain derivatives to trade on an OTC basis in appropriate circumstances would help minimise the costs that may arise from a move towards platform trading.

As for the additional analysis of the role of multi- or single-dealer platforms that IOSCO is due to complete, we would be happy to provide input into this work. We believe that single-dealer platforms can provide enriched content and functionality to the end-user and should be eligible as an execution venue for derivatives, existing alongside multi to multi platforms. Equally, we do not believe that allowing single-dealer platforms for derivatives in locations outside the US will create regulatory arbitrage.

On the other hand, limiting the choice of venues available to market participants through the introduction of rules that constrain the design of trading venues could indeed disadvantage end-users and inhibit their freedom of choice. It is also important to ensure that measures designed to encourage central execution and clearing, including higher capital charges imposed on banks for non-cleared transactions, are risk-based rather than punitive. They should also be carefully designed so as not to undermine clearing exemptions for end-users and to prevent costs being loaded onto the transactions of non-financial users of OTC hedges. This would be an undesirable outcome from the point of view of risk management.

## **Trade repositories**

Finally, considering the report's comments on reporting to trade repositories, we believe that if trade repositories are to deliver their core benefits in terms of financial stability monitoring, then there should be a measured approach to what information needs to be reported to them and an avoidance of the proliferation of local trade repositories. Likewise, regulators need to consider requirements to report to trade repositories in light of contractual and legal obligations concerning confidentiality of client information. The nature of supervisory access to that data should be defined accordingly. If client confidentiality is undermined, it could have a serious adverse impact on the functioning of the market. As far as exchange of data is concerned, we would also like to take this opportunity to highlight ISDA's work on Financial products Markup Language (FpML) and the recent publication by ISDA of a White Paper on Product Representation for Standardised Derivatives<sup>1</sup>. The proposals will support regulatory reform initiatives such as price transparency reporting and reporting to trade repositories, whilst also simplifying the trade processing and reporting architecture across the marketplace for standardised derivatives.

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<sup>1</sup> Available online at [www.fpml.org](http://www.fpml.org)



We thank the FSB once more for the opportunity to comment on this report.

Yours truly,

A handwritten signature in black ink that reads "Ajacobs".

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### **About ISDA**

Since its founding in 1985, the International Swaps and Derivatives Association has worked to make over-the-counter (OTC) derivatives markets safe and efficient.

ISDA's pioneering work in developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions, has helped to significantly reduce credit and legal risk. The Association has been a leader in promoting sound risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool.

Today, the Association has more than 800 members from 55 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to efficiently manage the financial market risks inherent in their core economic activities.

ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – show the strong commitment of the Association toward its primary goals; to build robust, stable financial markets and a strong financial regulatory framework.