Comments by the International Swaps and Derivatives Association, Inc. (ISDA) on the Consultation Paper on Proposed Regulation of OTC Derivatives issued by the Monetary Authority of Singapore

26 March 2012

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26 March 2012

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Dear Sir/Madam,

Introduction

The International Swaps and Derivatives Association, Inc. ("**ISDA**") welcomes the opportunity to respond to the Consultation Paper on the Proposed Regulation of OTC Derivatives ("**Consultation Paper**") issued by the Monetary Authority of Singapore ("**MAS**") on 13 February 2012.

Since 1985, ISDA has worked to make the OTC derivatives markets safer and more efficient. Today, ISDA is one of the world's largest global financial trade associations, with over 825 member institutions from 57 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, central counterparties ("**CCPs**") and other service providers. Information about ISDA and its activities is available on ISDA's web site: www.isda.org.

ISDA is actively engaged with providing input on regulatory proposals in the United States, Canada, the European Union and in Asia. Our response is derived from these efforts and from consultation with ISDA members operating in Singapore. Accordingly, our response draws on this international experience and dialogue and is not focused on technical aspects of Singapore law relating to the implementation of reform. Individual members will have their own views on different aspects of the Consultation Paper, and may provide their comments to the MAS independently.

ISDA commends the MAS for their careful consideration of these issues which would facilitate Singapore meeting G20 commitments regarding central clearing and trade reporting of OTC derivative transactions by the end of 2012. We also appreciate and support the objectives to reduce counterparty risk, improve overall transparency, protect against market abuse and ultimately reduce systemic risk in the OTC derivatives market.

General observations

Before we address the questions posed in the discussion paper, we would like to make a few general observations.

Global Markets, Regulatory Coordination and Timing

The MAS states in the Consultation Paper that in developing its proposals, it has taken into consideration ongoing international developments. Given the global nature of OTC derivatives and the relative size of Singapore's OTC derivatives market, the regulatory regime in Singapore will need to be in alignment with other major markets. We understand that it is not the MAS's intention to drive the reform initiatives. Indeed, the proposed reforms to the functioning of these markets are, to a large extent, more relevant for Europe and the United States than for relatively smaller markets such as Singapore. Given that context, we strongly urge the MAS to continue to gather the necessary information on the impact of the reforms in the US and EU markets and to continue to engage in international regulatory coordination and cooperative efforts prior to implementing substantial reforms in Singapore. Legislation should be introduced in a manner that allows for maximum flexibility in the future to take advantage of experience in other countries and permit on-going calibration and refinement.

In that regard, it should be acknowledged that the implementation of key financial market reforms in the US and EU, due to their scale and complexity, is facing delay. The implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**") has been put back by approximately six months, after the Commodity Futures Trading Commission and the Securities and Exchange Commission agreed to delay implementation from a deadline set by the U.S. Congress of end 2011 to July 2012. Similarly, the European Parliament has yet to formally finalise the text of the European Market Infrastructure Regulation ("**EMIR**"), which contains similar provisions on clearing and reporting of OTC derivatives to the Dodd-Frank Act.

In addition, we urge that the MAS consider the global nature of the markets when creating regulations for OTC derivatives so that the regulations do not restrict the ability of Singapore market participants to continue participating in and be competitive in the global OTC derivatives market. To this end, it is vital that regulators seek to avoid mandating duplicative, overlapping requirements and/or infrastructure where sufficient alternatives exist. Regulators should also be cautious not to introduce conflicting or uncertain requirements and to avoid creating opportunities for regulatory arbitrage.

Recognition of foreign CCPs

We welcome the MAS's proposal to not require central clearing through only domestic CCPs. However, we believe it is imperative for the MAS to complete its process for recognition of foreign CCPs from certain major jurisdictions (such as the US and EU) at the same time that mandatory central clearing is implemented in Singapore or to adopt a "grandfathering" approach to allow such CCPs to offer clearing services in Singapore as if they were an eligible CCP for the purposes of the mandatory clearing regime in Singapore. In addition, we would point out that certain derivative products may be customarily cleared on CCPs other than those in the US and EU and due consideration should be given in recognizing these CCPs. This would allow market participants to select the most appropriate CCP for clearing their OTC derivatives transactions. Also where affected entities are subject to mandatory central clearing in both Singapore and abroad, this will allow them to have the ability to comply with both regimes.

ISDA

Response to specific questions

The remainder of this letter sets out our comments in relation to the specific questions posed in the Consultation Paper. Our response is set out underneath each question. Capitalised terms used but not defined herein have the meaning given to such terms as set out in the Consultation Paper. The headings used below correspond to the headings used in the Consultation Paper.

2. PROPOSAL FOR EXPANDING THE SCOPE OF THE SFA TO REGULATE OTC DERIVATIVES

Question 1: MAS seeks views on the proposal to expand the scope of SFA to cover derivative contracts on commodities, credit, equities, foreign exchange and interest rates.

1. Members have expressed concern about the proposed expansion of the scope of the SFA to cover derivative contracts. Members would like to suggest that it may be unnecessary to expand the SFA to regulate OTC derivatives beyond amendments to meet the G20 requirements, in other words, to impose mandatory central clearing and trade reporting of OTC derivatives. Members have noted that the expansion of the scope of the SFA by the introduction of a new class of instrument – "derivative contracts" – may unnecessarily and inappropriately extend existing provisions in the SFA and related subsidiary legislation to such contracts.

2. In this connection, members are of the view that it would not be appropriate for a wholesale application of existing provisions in the SFA and related subsidiary legislation to OTC derivative contracts. Certain of these provisions may be more appropriate for the securities and/or futures industry and application to OTC derivatives contracts and OTC derivatives market participants would be unduly onerous and, in some cases, entirely unsuitable. One specific example is in respect of client money and asset rules and how these would apply considering the commonplace use of ISDA credit support documentation which provides for title (or outright) transfer of collateral. Regard must also be given to the nature of the OTC derivatives market which is largely a wholesale rather than a retail market. Participants typically act as arm's length counterparties and where appropriate, obtain their own separate legal and financial advice before entering into transactions.

3. Members have also expressed concern as to whether the proposed expansion of the scope of the SFA to OTC derivative contracts would result in a significant increase in business and compliance costs without any commensurate increase in the safety and soundness of the financial system in Singapore. In the event the MAS proceeds with the expansion then, with regard to individual licensing and potential examination requirements (if any), we propose that the MAS provides a transitional arrangement where existing industry participants be excluded from the revised fit and proper checks requirements and be allowed to be registered as representatives. This is necessary to prevent a lapse of time in the conduct of OTC derivatives transactions while waiting for results of fit and proper checks. In this regard, it is essential the licensing be immediate instead of the usual 7 to 14 days waiting period following the receipt of lodgment for the appointment of the representatives. In the event the examination requirements are implemented, we propose

that the experienced market participants engaging in OTC derivatives be exempted from such requirements or an in-house certification course be considered in lieu of examination for these experienced hires.

4. In any case, whether to apply only to mandatory central clearing and trade reporting or if there is a wider expansion of the SFA, the proposed definition of "derivatives contracts" must be clear and appropriate. The definition should be defined carefully to exclude transactions in the underlying assets. It is not clear from the Consultation Paper whether, for example, physically-settled commodity transactions with embedded derivative features, securitized derivatives (i.e. structured products) or instruments with embedded derivatives would be "derivative contracts" for the purposes of the expansion of the scope of the SFA. In the context of the G20 OTC derivatives reforms, there is a consensus amongst global regulators that the OTC derivative contracts subject to such reforms (i.e. mandatory central clearing and trade reporting) are bilateral transactions that do not include securitized derivatives and/or embedded derivatives and we would urge the MAS to adopt this approach.

5. We urge the MAS to consult further with market participants on the proposed definition of derivatives contracts and the proposed amendments to the SFA and related subsidiary legislation for the regulation of derivative contracts. Any expansion of the SFA to introduce onerous or inappropriate licensing and/or other regulatory requirements may negatively impact the OTC derivatives market in Singapore.

3. CLEARING MANDATE

Question 2: MAS seeks views on:

(i) the proposal to adopt top-down and bottom-up approaches to identify products suitable for mandatory central clearing;

6. Members generally support the MAS's proposal to adopt top-down and bottom-up approaches to identifying products suitable for mandatory central clearing. However, the optimal method should involve a carefully balanced combination of both the top- down and bottom-up approaches. Further, it is important from a risk management perspective that, when determining whether the scope of mandatory central clearing should be extended to cover additional OTC derivatives products, the MAS should adopt a prudent approach which gives due consideration to the systemic risks which may be created by clearing such OTC derivatives products on CCPs.

7. In respect of the top-down approach, while the MAS may consider that it is important to have the ability to directly control the scope of the mandatory central clearing, this approach has the potential to increase systemic risk as a regulator may not be in the best position to determine suitability of any particular product for clearing or whether eligible CCPs are sufficiently prepared to provide clearing services in respect of such products. As further referred to below, this determination relates in a large part to such risk management issues as the liquidity of the product and the valuation and margining of the product, which may be more appropriately determined in conjunction with the eligible

CCPs and market participants. We would urge the MAS to have regard to the relevant recommendations set out in the OICV-IOSCO paper of February 2012 entitled "Requirements for Mandatory Clearing" ("**OICV-IOSCO Paper**"), in particular Recommendations VIII, IX and X.[1]

8. Under a bottom-up approach, the MAS will be required to consider the merits of any applications from eligible CCPs to expand the mandatory clearing regime to new OTC derivatives products in respect of which such eligible CCPs propose offering clearing services. However, systemic risk may also arise in a bottom-up approach because eligible CCPs may not be in a position to properly consider and address the impact that an extension of mandatory central clearing to a new OTC derivative product would have on the wider OTC derivatives market (such as the effect on systemic risk, the implications for market liquidity of the OTC derivatives product and/or whether market participants are sufficiently prepared from an operational and risk management perspective to clear such products through eligible CCPs). This risk is especially pronounced where an eligible CCP may be set to profit from an extension of its clearing services, since incentives may exist for it to take on more risk than is appropriate. We would urge the MAS to have regard to the relevant recommendations set out in the OICV-IOSCO Paper, in particular Recommendations IV, V and VI.[2]

9. Therefore we believe it very important that any change in the scope of mandatory central clearing in Singapore should be made through a carefully balanced combination of the top-down and bottom-up approach, where the MAS would be required to work closely with eligible CCPs and market participants to determine the suitability of including an OTC derivatives product in the mandatory clearing regime.

10. Furthermore, market participants, who are the ones most subject to the risks associated with inappropriate clearing, need to be provided with an appropriate period of consultation to allow them to comment on any potential extension of the mandatory central clearing in Singapore under both the top-down approach and the bottom-up approach.

[1] Recommendation VIII: A determining authority should consider using a top-down approach and may utilise a range of information sources in order to identify products which it considers may be suitable for mandatory clearing.

Recommendation IX: A determining authority should consult with stakeholders as part of its decision-making processes under the top-down approach to allow stakeholders to provide input on whether a product may be appropriate for a mandatory clearing obligation.

Recommendation X: A determining authority should clearly identify and disclose what steps are available to it for products identified under the top-down approach as suitable for mandatory clearing but which are not currently cleared.

[2] Recommendation IV: In assessing a mandatory clearing obligation, a determining authority should consider information from a range of sources, including trade repositories.

Recommendation V: In assessing a proposal for a new clearing obligation under the bottom-up approach, a determining authority should conduct a public consultation.

Recommendation VI: Once a determining authority has reached a decision as to whether a product should be subject to a clearing obligation under the bottom-up approach, the determining authority should make the decision publicly available.

(ii) the proposed criteria (paragraph 3.1.4) for determining whether a product is suitable for mandatory central clearing by a CCP; and

11. Members agree with the proposed criteria listed. However, we suggest that the following criteria (similar to those set out under the Dodd Frank Act and EMIR) should also be considered:

    (a) Whether there are substantial notional exposures, liquidity and the availability of market data in respect of such product;

    (b) Whether the eligible CCPs and market participants are able to properly and suitably determine the exposures created under and risk manage the type of OTC derivatives product under consideration for mandatory clearing;

    (c) Whether an appropriate infrastructure framework (such as operational expertise and margining capabilities) is in place in respect of the trading and settlement of such product;

    (d) Whether there are anticipated positive effects on the OTC derivatives market if such product becomes subject to mandatory clearing;

    (e) Whether there are any projected harmful effects on CCPs if such product becomes subject to mandatory clearing;

    (f) Product characteristics including analysis of complexity, volatility, tail/gap risk and dependency/correlation risk in member cleared portfolios; and

    (g) Whether there is a reasonable level of certainty as to the legal treatment in the event of insolvency of any CCP or its clearing members.

    The above criteria should be interpreted strictly when determining whether a type of OTC derivatives contract should become subject to mandatory central clearing in order to properly manage the risks associated with inappropriate mandatory clearing.

12. Furthermore, we suggest that due consideration be given to the following factors when determining if a product should be subject to mandatory central clearing:

    (a) the cross-regional aspects of such product (if any) and whether any cross-jurisdictional issues arise;

    (b) the size of the market captured by the proposed regime (with one party booking in Singapore) as this market will have different characteristics to the global market in particular products;

    (c) the costs of submitting such products to clearing which will be passed on to market participants;

(d) the costs for market participants and end-users resulting from a potential fragmentation of the OTC derivatives market with respect to such types of products and from inefficient use of regulatory capital as a result of such fragmentation;

(e) the availability of other CCPs which already offer clearing services in respect of such products in an acceptable overseas jurisdiction; and

(f) where only one CCP exists that can clear the relevant product, competition and market issues. This is because, allowing a de facto regulatory driven monopoly in clearing a particular product may distort market incentives.

13. The relevant product that is to be subject to mandatory central clearing must be clearly specified. Further, there needs to be clarity on whether that product is subject to the mandate if it is embedded in, or part of a structured derivative transaction. We would submit that it should not be subject to the mandate as the CCP would not be able to clear the transaction as a whole, and requiring clearable portions of the transaction to be cleared would adversely affect the risk profile and economics of the transaction as a whole.

14. We also refer you to ISDA's submissions to the US Securities and Exchange Commission ("**SEC**") and Commodity Futures Trading Commission ("**CFTC**") on the process for determining which swaps should be subject to mandatory clearing, copies of which are attached in Appendix 1 to this letter.

(iii) the feasibility of mandating central clearing for SGD IRS, USD IRS, and NDFs in selected Asian currencies.

15. In addition to the factors mentioned above, we urge the MAS to carefully consider whether the imposition of mandatory central clearing in respect of such products, and the timing of such imposition, will negatively impact the ability of market participants to risk manage their businesses efficiently and/or result in increased systemic risk to the OTC derivatives market.

16. If the market in a certain type of product spans across several jurisdictions, it would be counterproductive to the risk management of such product for each jurisdiction to impose its own mandatory clearing obligation on this product as this may result in the break-up of netting sets among market participants (which such market participants rely on to manage their counterparty credit risk) and a fragmentation of the market in such type of product across each jurisdiction. This may hinder the ability of the market to effectively and efficiently manage its risk in respect of such product.

17. In addition, this may lead to a reduction in the liquidity of a product which may in turn result in a reduction in the market efficiency in respect of such product with the knock-on effect that the costs of such products may increase. These increased costs will inevitably be borne by end-users of such transactions in Singapore thereby reducing the ability of end-users to use derivatives efficiently to risk manage their businesses and further damaging the liquidity of the Singapore OTC derivatives markets. Given the recognised

importance of the OTC derivatives market for the economic development of Singapore as well as Asia, this may have an unintended and damaging effect on the development of the Asian economies.

18. We urge the MAS to consider the existence of mandatory clearing obligations with respect to the proposed products in other jurisdictions and the level of clearing that already takes place for these products (even without the clearing mandate) as well as the size of the Singapore booked share of the global market to ensure that mandating clearing of these products would in fact result in systemic risk reduction. Members requests that the MAS ensures in defining the product scope that it captures only standardised, flow transactions rather than customised or hybrid transactions.

19. If mandatory central clearing of such products is to be imposed, the timing of such imposition and the availability of eligible CCPs at such time is key. We would suggest that mandatory central clearing for such products not be imposed until and unless appropriate eligible CCPs are available to market participants. These eligible CCPs may include foreign CCPs and as such the approval or recognition of such foreign CCPs under the proposed regulatory framework would need to take place prior to such imposition.

20. In respect of the particular products proposed:

(a) Members request that the MAS reconsider whether USD IRS should be subject to mandatory clearing. Members would like to submit that it may not be necessary or suitable to require mandatory clearing of USD IRS in the light of the suggested criteria in paragraph 3.1.4 of the Consultation Paper and the criteria and factors mentioned in our response to Question 2(ii) above; and

(b) Members seek clarity on the Asian currencies that will be in the scope for mandatory central clearing of NDFs and request that the MAS conducts further consultation with market participants.

Question 3: MAS seeks views on the proposal to exempt foreign exchange forwards and swaps from mandatory central clearing.

21. Members fully support the proposal to exempt foreign exchange forwards and swaps from mandatory central clearing for the reasons set out in the Consultation Paper. This is in line with proposed international regulatory reforms.

22. Members have requested for clarification on the following:

(a) That foreign exchange spot transactions would not be OTC derivatives and therefore not subject to mandatory central clearing; and

(b) That these will not be the only products that are exempted from mandatory central clearing - there may be other products which are exempted and the SFA will provide for an avenue for specification of exempted products from time to time.

Question 4: MAS seeks views on the proposal to require transactions which fulfill the criteria stated in paragraphs 3.2.1 and 3.2.2 to be subject to the clearing obligation.

23. We are in principle supportive of the proposal to look to the location of where the contract is booked and of contracting parties to determine whether mandatory central clearing should apply. However, we have the following concerns:

    (a) It will be important to clarify where a contract is treated as being booked, particularly where one party to the contract is a multibranch entity and may be acting through its head office or branch in Singapore; and

    (b) It will be important to clarify when a party is treated as being resident or having a presence in Singapore.

    Clear definitions for the same would be required.

24. We welcome the proposal to not include derivative contracts between entities that are neither resident or having a presence in Singapore. It is common in the Singapore market for market participants to book OTC derivative transactions in their head offices or offshore branches for a variety of reasons. We urge the MAS to ensure that the carve out (which would apply where it is "necessary or appropriate to prevent the evasion of Singapore's derivatives regulations") not be applied subjectively and that clear objective criteria be set out in primary or secondary legislation in order for market participants to understand how this would be imposed. Members would like to point out that there have been significant issues raised at the technical consultation stage in connection with anti-evasion rules in EMIR and members have concerns that they should be able to continue to have flexibility to use alternative transaction/branch/affiliate structures.

25. Members have requested for clarification that where an OTC derivative contract is executed by an agent on behalf of a principal, the location of where the contract is booked and the residence or presence in Singapore would be that of the principal rather than the agent. This is relevant, for example, in the case of funds where a fund manager may execute an OTC derivative contract on behalf of an individual fund.

26. We query whether the MAS has considered the application of an exemption to transactions where contracting parties (who would otherwise be caught by the mandatory central clearing requirements) are already subject to mandatory central clearing rules in acceptable overseas jurisdictions. In any event, if mandatory central clearing is imposed prior to the recognition by the MAS of foreign CCPs, we would suggest that the MAS consider the introduction of such an exemption until suitable eligible CCPs are available. This is because, unlike mandatory reporting where an entity subject to two distinct mandatory reporting regimes may comply with both regimes by reporting the relevant transaction to multiple TRs, it is not possible to submit a transaction to central clearing through two separate CCPs.

Question 5: MAS seeks views on the proposed scope of entities to be subject to clearing obligations and on the factors to be taken into account when determining the clearing thresholds.

27. Members support the MAS's proposal to impose clearing thresholds for both financial and non-financial entities as set out in the Consultation Paper. However, more detail must be provided in relation to the proposed clearing threshold mechanism, both in relation to how the threshold levels will be set and calculated as well as how (and how frequently) they will be tested to determine whether an entity is subject to mandatory central clearing in respect of relevant transactions. We strongly urge the MAS to conduct further consultation in relation to this issue once further details are available.

28. Our initial comments on the proposed clearing threshold mechanism are as follows:

(a) The Consultation Paper suggests that clearing thresholds will be determined by reference to "derivative exposures". It is unclear at this point in time whether this refers to notional amounts of transactions or mark to market exposures, although it would appear to us to be the latter. As the MAS is aware, calculating the outstanding positions of a market participant on the basis of the notional (average or otherwise) value of such positions may not in all cases reflect the true level of risk to which such market participant is exposed. At the same time, we recognize that any determination based on the mark-to-market value of outstanding positions would be difficult to implement. The mark-to-market value of outstanding positions may fluctuate frequently and therefore make calculations difficult. Furthermore, there may be some variation in the methodologies used to calculate mark-to-market valuations, which may limit the practical application of mark-to-market valuations in determining whether a clearing threshold has been exceeded. We request for further consultation on the calculation methodologies once these are available;

(b) The proposals in the Consultation Paper suggest that the determination of the clearing threshold would take into account the entity's derivative exposures "in aggregate". This seems to suggest that transactions that are not subject to mandatory central clearing would be taken into account in the calculation of the clearing threshold. We would suggest that this is not appropriate and only transactions that are subject to mandatory central clearing should be taken into account. The implementation of such a calculation methodology could lead to the unsatisfactory result that a market participant may have only one transaction subject to mandatory central clearing, but be required to clear such trade (and suffer all associated infrastructure costs) by virtue of the size of its other transactions that are not subject to mandatory central clearing;

(c) We would also propose that the clearing threshold be applied for each individual group of trades that is subject to mandatory clearing. Therefore, to the extent that an entity exceeds the threshold in a particular market type, it will not be required to clear trades of a different type that does not separately meet the threshold. An entity that does not have significant exposure in a particular market type should not be required to bear the costs in submitting those trades for clearing simply because it has a large exposure in a different type of trade;

(d) We seek clarity as to who is to monitor a counterparty's derivatives exposure and whether it is above the clearing threshold. A party would not be in a position to determine whether its counterparty exceeds a clearing threshold as such counterparty may have entered into multiple transactions with other parties. We suggest that a party be entitled to rely on appropriate representations by its counterparty; and

(e) We note the MAS's proposal that hedging transactions be determined by reference to qualification for hedging treatment under financial reporting standards. In this connection, members are concerned that non-financial entities may have difficulties meeting the technical hedging treatment requirements under such reporting standards. Members suggest that an alternative approach could be to determine hedging transactions by ascertaining the genuine hedging purpose of the transaction by reference to internal risk management and/or hedging policies of such entities. The issues that have been raised in the technical consultation on the hedging exemption in EMIR needs to be borne in mind.

29. Members have also requested for clarification on the following:

(a) Express confirmation that if an entity's counterparty is exempt from mandatory central clearing that such entity is also exempt from mandatory central clearing. We think this is logical as a contract can only be cleared if both parties engage in clearing that contract, but would appreciate this to be expressly stated; and

(b) Whether non-financial entities subject to mandatory central clearing include individuals.

30. Members have queried the consequence of breach of the clearing mandate. In this connection, members request for legislation to provide that even if an OTC derivatives contract which is subject to the clearing mandate remains uncleared, this will not affect the legal, valid and binding nature of such transaction. Members consider that legislation will need to address this issue specifically as contracts which are in breach of legislation (in this case, the clearing mandate) may be treated as illegal and/or void. In order to prevent legal uncertainty in respect of such contracts, it is therefore necessary for the MAS to include a legislative provision which, apart from setting out the penalties for failing to comply with the clearing mandate, will also state that such uncleared trades will remain legal, valid and binding on both parties to the contract.

31. As non-financial entities above the clearing threshold will be subject to mandatory central clearing, and such entities are unlikely to be members of eligible CCPs, client clearing will be necessary. We would welcome the opportunity to provide feedback to the MAS on the various models for client clearing (for example the agency model used by Futures Commission Merchants in the US) and structural and legal issues that may arise in CCPs in effecting client clearing (including in relation to margin segregation and portability).

32. Members have requested for clarity on the proposed regulatory capital requirements for centrally-cleared trades as well as for uncleared trades and would urge for further consultation prior to the implementation of such proposals.

Question 6: MAS seeks views on the proposal to exempt certain public bodies from the clearing obligation.

33. Members have no objection to the proposal to exempt certain public bodies from the clearing obligation but would require further clarity on the following points:

(a) Whether sovereign wealth funds would be subject to the exemption;

(b) Whether a list of "non-profit state-owned bodies that have explicit guarantee arrangements provided by the Singapore government" will be provided as it may not be evident to market participants;

(c) Whether the list of entities set out in footnote 9 of the Consultation Paper will also be extended to foreign governments; and

(d) Whether the reference to central governments will be extended to provincial or state governments in federations (such as the US, Australia and Canada).

Question 7: MAS seeks views on:

(i) the proposal to exempt intra-group trades of both financial and non-financial entities from the clearing obligation but subject these trades to appropriate collateralisation requirements

34. We strongly support the proposal to exempt intra-group trades from the clearing obligation. We also suggest that intra-group trades should be exempted from mandatory reporting.

35. Members suggest that the intra-group exemption should apply without the need for specific regulatory approval of such exemption. The relevant provisions should instead allow for a clearly defined exemption that market participants can assess for themselves.

36. We note MAS's proposal that intra-group trades be nevertheless subject to appropriate collateralisation requirements. We strongly encourage the MAS not to apply such collateralisation requirements. Intra-group trades are used for internal hedging and risk management and do not increase systemic risk or threaten the safety and soundness of entities under common control. Margin is necessary as a risk matter to protect against the risk that such entity cannot meet its contractual obligations. There is no need to require margin for transactions between affiliates because any gains or losses do not create risk for the larger entity. Any gain on one entity is an equal and offsetting loss on the other resulting in a neutral position across the corporate group. Inter-affiliate trades simply represent an allocation of risk within a corporate group. Therefore, intra-group transactions do not present systemic risk. Accordingly, it is not appropriate to impose margin requirements on intra-group transactions. There is a significant cost in locking up

collateral for such intra-group trades (where the credit exposure is intra-group) but this will not result in any net benefit to counterparties.

37. If nonetheless the MAS determines that intra-group trades are to be subject to collateralisation requirements:

(a) We request that the MAS consider applying an exemption similar to that under the proposed EMIR which applies to intra-group transactions where two conditions are met: (i) there is no current or foreseeable practical or legal impediment to the prompt transfer of own funds and payment of liabilities between the counterparties; and (ii) the risk management procedures of the counterparties are adequately sound, robust and consistent with the level of complexity of the derivative transaction;

(b) We urge the MAS to consider the discussions and any recommendations on this topic under the auspices of the Basel Committee on Banking Supervision and IOSCO;

(c) We encourage further consultation on how such collateralisation requirements are to be calculated and imposed; and

(d) Members have suggested that the relevant entities be given the option to clear such trades instead of meeting such collateralisation requirements.

(ii) whether such a proposal would pose any implementation issues; and

38. The imposition of collateralisation requirements will add significant costs and operational burden without necessarily achieving any significant benefits for the reasons set out above.

(iii) whether there are other appropriate risk mitigating measures, apart from subjecting the exempt intra-group trades to collateralisation requirements.

39. For the reasons set out above, we do not believe any risk mitigating measures are required to be imposed in respect of intra-group trades.

Question 8: MAS seeks view on the proposal not to exclude pension schemes from clearing requirements.

40. In order to ensure that entities booking a transaction in Singapore are not disadvantaged as compared to entities in other jurisdictions (such as the US and EU) when dealing with pension schemes (whether Singapore or foreign) (e.g. a Singapore bank facing a foreign pension fund), we would encourage the MAS to reconsider this point and consider exempting pension schemes from the clearing requirements.

41. Generally we are of the view that there should be:

(a) *Exemptions for commercial end-users*: We believe that affordable access to appropriate methods of hedging, including the use of OTC derivatives, is vital to end-users as they seek to mitigate risks and maintain their economic viability. We caution against implementing regulation that would make access to these critical risk management tools either too difficult or too expensive to attain. Commercial end-users often have risk-management needs that are unique to their individual situations. For example, the location (basis), volume, timing and duration of derivatives required may vary from party to party, depending on individual hedging needs. Standardised offerings alone, therefore, are rarely adequate. Requiring such standardisation could expose participants to additional market risk. Also, commercial end-users generally do not have the systems in place to manage CCP margining requirements and may opt not to hedge rather than tie up working capital. Legislation should not provide a disincentive to hedge commercial risks. This is recognised in end-user clearing exemptions proposed under the Dodd-Frank Act and EMIR.

(b) *Limited, proportionate exemptions for non-systemic financial entities*: We are concerned that requiring non-systemic financial entities to use CCPs will have liquidity effects which are insufficiently understood at present, and, given the way that derivatives are used to manage overall portfolio risk, may artificially and inefficiently isolate derivatives components from the rest of these portfolios, requiring posting of high levels of margin on derivatives and not net exposures.

Question 9: MAS seeks views on the proposal not to require central clearing through only domestic CCPs.

42. Members are strongly supportive of this proposal. It is not necessary or desirable for mandatory central clearing in Singapore to require domestic clearing for compliance since this will result in fragmentation of liquidity and the break-up of netting sets and which will in turn entail higher costs for end-users of OTC derivatives products in Singapore. Furthermore, imposing domestic clearance for compliance would remove the ability of market participants to select the most appropriate CCP for the clearing of their OTC derivatives transactions and may over time also lead to the excessive build up of systemic risk in the Singapore CCP. This may ultimately result in the need for Singapore governmental support if there is ever a failure of the Singapore CCP.

43. Members have however expressed concern about the reservation in paragraph 7.2.5 of the Consultation Paper of a broad power to require overseas RCHs to set up a subsidiary in Singapore and be regulated as a locally-incorporated RCH or ACH. This would appear to cut down the MAS's position that they will not require the domestic location of eligible CCPs to be Singapore.

Question 10: MAS seeks views on:

(i) the proposal to require backloading of outstanding derivative contracts with remaining maturity of more than one year; and

(ii) any potential implementation challenges in requiring backloading of outstanding derivative contracts.

44. Members strongly discourage the backloading of outstanding derivative contracts of any duration and would encourage the MAS to reconsider this proposal. There are major legal and practical challenges in connection with backloading.

45. Affected contracts would have been agreed bilaterally, and their pricing will be contingent upon market conditions at the time, credit quality of the counterparties, collateral posted etc. There is concern that a retroactive clearing requirement could be open to legal challenge.

46. Further it is impossible for a single market participant to comply without agreement from their counterparty on the terms of compliance. We believe this is the key practical problem with this proposal. It is a consideration that is unique to bilateral negotiated derivatives, and it may differentiate this case from other cases where retroactivity may be practically possible. Even if one of the counterparties to the contract wants to comply with the clearing requirement, there is no mechanism facilitating this if that counterparty's counterparty will not agree terms (e.g. because of (new) pricing conditions and disagreement over which CCP to use). We believe that this may cause hundreds of cases of non-compliance, even if counterparties wish to comply. Ultimately, this will be a major problem for the regulator.

47. It is worth noting that the EU has abandoned proposals for backloading. With respect to frontloading which was suggested under EMIR (but also strongly opposed by market participants), we also strongly oppose introducing such a requirement for the same reasons set out above. It would almost certainly introduce uncertainty in the market, particularly in respect of pricing of trades.

4. REPORTING MANDATE

Question 11: MAS seeks views on the proposal to implement the reporting obligation in phases, specifically on the proposal to include interest rate, foreign exchange and oil derivative contracts in the first phase.

48. We are supportive of the proposal to implement the reporting obligation in phases. However, members would like the reporting mandate to be in line with requirements under other reform initiatives such as the Dodd-Frank Act and EMIR. Given that final rules globally are yet to be confirmed, members urge that rules for trade reporting be developed with sufficient flexibility to take into account international developments. In order for this, members request that implementation of the first phase of the reporting mandate in Singapore should not be earlier than that under the Dodd-Frank Act and EMIR. Members also urge the MAS to consider the significant technical challenges posed by the implementation of the reporting mandate. Where possible, members encourage the development of rules that would allow for and promote the creation and use of global TRs in each relevant asset class.

49. With respect to the proposal to include interest rate, foreign exchange and oil derivative contracts in the first phase:

(a) We would encourage that the type of contracts within each asset class to be subject to the reporting obligation be clearly specified. For example, the current proposal is too broad and may inadvertently capture customized derivative contracts or structured products with embedded derivatives for which reporting is currently not supported by any existing trade repository. We urge the MAS to have regard to the ultimate aim of trade reporting, being the reduction of systemic risk in the OTC derivatives market, when determining what particular types of contracts should be subject to the reporting mandate. Further if the type of contracts to be subject to the reporting obligation are already being reported under other regimes (e.g. under the Dodd-Frank Act), this would assist in compliance in the first phase;

(b) Members request that the MAS clarify the reporting obligation in respect of complex/structured/hybrid/basket trades. If such trades include a reportable component, would that trade require reporting? If yes, what is required to be reported? Would it simply be the reportable component or the whole trade? In this connection, members note that the relevant TR may not be able to accept reporting of the whole trade;

(c) Members request a sufficient transition period to allow market participants to effect infrastructure and system changes that are required to meet the reporting obligation;

(d) We note the proposal that eligible TRs could include foreign TRs. This could include DTCC. In this connection, although DTCC will be able to provide event based data for IRS by June 2012, it will not be providing this service for NDFs until 2013 at the earliest. Before then, it will only be providing end of day/snap-shot information. We would encourage that any reporting obligation in respect of NDFs be aligned with DTCC so that market participants are not required to provide event based data for NDFs before such data is available from DTCC;

(e) Given the operational and infrastructure challenges for implementing the first phase, members would propose that oil derivative contracts not be included in the first phase; and

(f) Members query if certain types of contracts will be exempted from the reporting mandate. Examples could include intra-group trades and hedging transactions.

Question 12: MAS seeks views on the proposal to require all transactions booked or traded in Singapore to be reported.

50. We are supportive of the proposal to require transactions "booked" in Singapore to be reported, but would request that it be clarified where a contract is treated as being booked, particularly where one party to the contract is a multibranch entity and may be acting through its head office or branch in Singapore.

51. Members have concerns about requiring transactions "traded" in Singapore to be reported. It is unclear what is meant by "traded" – for example, does this look to the location of the individual "trading" the contract, the entity for which that individual is employed or the counterparty that enters into that contract? The inclusion of contracts "traded" in Singapore would appear to capture trades which are booked offshore (and in respect of which the risk does not lie in Singapore) and could potentially result in multiple parties having an obligation to report. Also, where a contract is executed by an agent on behalf of a principal, would this require such an agent that is resident or having a presence in Singapore to report the contract, notwithstanding that it is executing the contract on behalf of a principal which is not resident or having a presence in Singapore?

52. Members seek clarification that MAS's proposal is to require only contracts "booked or traded in Singapore" to be reported, and not also any other contracts with a Singapore connection such as contracts denominated in Singapore dollars or where the underlying reference entity is resident or having a presence in Singapore as mentioned in paragraph 4.2.2 of the Consultation Paper. If the intention is to include such other contracts, members oppose such proposal for the reason set out in that paragraph.

Question 13: MAS seeks views on:

(i) The proposal to require reporting by all financial entities, as well as non-financial entities above a reporting threshold; and

53. The industry understands the importance of properly-managed TRs in providing the regulator with trade data, including client names, to enable them to develop a more complete view of OTC derivatives market activity and thereby enhance their ability to oversee the market and its participants. The industry is committed to providing as much of the required data to TRs as it is legally able to do.

54. At the same time, it is important that dealers be protected from the potentially severe legal consequences of providing confidential client trade details to TRs arising from local data protection and client confidentiality laws. Obtaining the client’s consent (which in many cases must be informed consent) can overcome this in most jurisdictions. However, ISDA’s discussions with members indicate clearly that clients will be reluctant to give that consent. In particular, the ultimate clients of a fund manager will probably have stringent confidentiality requirements in their investment mandates that would prohibit such disclosure. Dealers may be under similar constraints vis-à-vis their own clients.

55. The best solution is ultimately changing the relevant laws to permit disclosure in certain specified circumstances regardless of legal or contractual restrictions. EMIR includes such a provision.

56. In view of Singapore's stringent banking secrecy laws, we believe legislative change should be prioritized, although we recognise legislative changes may require long lead times. Any legislative change should be wide enough to cover any mandatory trade reporting to TRs (including through third party service providers) and regulators (not just the MAS but also any regulators in third countries to which a market participant is

required to mandatorily report to. This is particularly important for global institutions). In the interim, the industry is faced with the difficult prospect of having to manage conflicting regulatory requests and requirements and contractual obligations. Given the challenges posed by local confidentiality laws, we would propose that if legislative changes as suggested above are not forthcoming, an exemption from the reporting obligation should apply when local laws prohibit trade reporting.

57. Except to the extent that a legal framework – involving both contractual consent and broad-based, consistent legislative change – permitting the contemplated disclosures is put in place, firms may have to screen data that they have for each customer (or class of customer) and manually block its disclosure, and will therefore not be able to provide client names. It should be noted in this regard that the provision of client data, even on a no-names basis, involves legal, relationship and reputational risks to firms. Some firms currently providing trade data to TRs on a no-names basis face the risk that doing so may breach contractual confidentiality obligations to their clients.

58. We believe that confidentiality is the cornerstone of the data reporting system. It should therefore be expected that any relevant regulator seeking access to information from TRs should publicly commit themselves to following high standards, as well as to publishing information on the relevant legal framework regarding their confidential use of information. Additionally, we believe that any public reporting of market activity - aggregated or otherwise - should not cause inappropriate or commercially sensitive information to be disclosed, undermining the safe and effective performance of financial markets. In particular, if there is going to be public reporting of reported trades, every effort should be made by TRs to avoid impacting the reporting entity's ability to properly hedge itself for the reported trades in the market. Preferably, any public reporting should be made with sufficient time lag to allow the market participant involved sufficient time to properly hedge itself in the market. Moreover, if the time delay for public reporting proposed by any TRs is not sufficient for certain large or more structured trades to be fully hedged, then certain exceptions should be granted to such trades to allow adequate time delay for appropriate hedging. There needs to be further clarity around the type of data that is legally required for publication, and this data should only be published by those legally entitled to publish it. We would urge the MAS to consult further with market participants on the scope, nature and timing of public reporting.

59. Members have also requested for clarification on the following:

(a) Whether an entity would be subject to the reporting mandate if their counterparty is exempt from the reporting mandate;

(b) Whether non-financial entities would include individuals. If so, members would like to suggest that it may be appropriate for different reporting thresholds to apply to non-financial entities depending on their constitution (e.g. individual versus corporate); and

(c) With respect to the proposal that the reporting obligation apply to Singapore-incorporated banks on a group-wide basis, that such reporting is required only for transactions booked or traded in Singapore. Members also request for more clarification on how such group-wide reporting is to apply.

60. Under the Dodd-Frank Act, reporting of all swaps is required and ISDA has generally been supportive of this. However, we recognize that different considerations apply to the Singapore market which is relatively smaller and requiring reporting across-the-board may impose too onerous a burden on non-financial entities that are minor participants in the market.

(ii) The proposal to determine the reporting threshold based on the asset size of the non-financial entity.

61. Members welcome the MAS's proposal to adopt a specified reporting threshold for non-financial entities. See also paragraph 59(b) above.

62. We are of the view, however, that given that the mandatory reporting obligation only applies to certain contracts, it should only be those contracts which ought to be taken into account in assessing the reporting threshold. Likewise, where transactions have been exempted from reporting (for example, hedging transactions), one should not be required to take them into account for the purposes of calculating the reporting threshold.

Question 14: MAS seeks views on the proposed protocols for single-sided reporting and for the use of third party service providers to fulfill reporting obligations.

63. We support the proposal to allow for single-sided reporting and for the use of third party service providers to fulfill reporting obligations. However, members also request that some flexibility be retained to allow for double-sided reporting, particularly if the requirement for both parties to the contract to retain responsibility for the timeliness and accuracy of information submitted is imposed.

64. With respect to the proposed protocols for single-sided reporting, we understand that, notwithstanding the proposed protocol, the MAS expects all the parties to the derivative contract to retain responsibility for the timeliness and accuracy of the information submitted. There is concern how a party may fulfill such responsibility where the other party is to report the transaction in accordance with the proposed protocol. We urge the MAS to consider providing for certain criteria by which a party (that is not the party to report a transaction under the proposed protocol) may fulfill such responsibility, and where possible to follow the lead of regulatory reform elsewhere (such as under the Dodd-Frank Act) on this issue.

65. With respect to the use of third party providers to fulfill reporting obligations:

(a) For the same reasons set out in our response to Question 13(i), we propose changing the relevant local laws to permit disclosure by parties subject to the reporting mandate to third party service providers in specified circumstances regardless of legal or contractual restrictions.

(b) We propose that the relevant party subject to the reporting mandate not be held responsible for the timeliness and accuracy of data reported by such third party service providers where such party has satisfied certain criteria. We would like to submit that the any mistake committed by third party service providers (that may be trade matching and confirmation platforms or overseas TRs) should not be attributable to the relevant entities or lead to penalties unless the mistakes are due to willful breach or gross negligence of those entities. Imposing a strict liability on the entities which are subject to the reporting requirement will only discourage the use of reporting agents and increase compliance costs for Singapore market participants.

Question 15: MAS seeks views on the proposal to exempt certain public bodies from the reporting obligation.

66. Members have no views on this proposal, other than to request the MAS to clarify that parties involved in such contract with such public bodies (which would otherwise be caught by the reporting mandate) would similarly be exempt from the reporting obligation.

Question 16: MAS seeks views on the proposal to adopt international data reporting and aggregation standards recommended by CPSS-IOSCO, including the requirement for parties to derivative contracts to provide information updates to the TR to ensure that TR data on the transaction remains accurate through the life of the transaction.

67. We strongly encourage the adoption of international data reporting and aggregation standards recommended by CPSS-IOSCO. However, given that final regulations, rules and standards globally are yet to be confirmed, we strongly recommend that TRs and rules for trade reporting be developed with sufficient flexibility so that they can quickly react to new or changing requirements.

Question 17: MAS seeks views on the adoption of an LEI and a product classification system aligned with international standards.

68. We encourage the adoption of an LEI and a product classification system aligned with international standards. However, given that such systems have not yet been fully implemented globally, we strongly recommend that the local TR and systems for trade reporting be developed after or in tandem with international developments.

69. Adoption of an LEI may not, however, work for all entities (e.g. insurance companies which are required to segregate transactions that are attributable to one fund from transactions that are attributable to a different fund. In respect of such entities, the MAS may need to explore creating different LEIs in respect of each fund).

Question 18: MAS seeks views on the proposal to require reporting of contracts (and any updates) within one business day of the transaction.

70. We request for further consultation to be conducted following finalization of the types of contracts to be subject to the reporting mandate and the scope of information to be

reported. We would suggest that different timings may be appropriate for different types of contracts.

71. The reporting timing would need to take into account the location of the reporting entity and, as such, any time-zone differences and non-business days in the relevant location.

72. Members urge the MAS to consult further on any on-going reporting/updating requirements due to the technical issues that may be involved.

Question 19: MAS seeks views on the proposal to backload relevant pre-existing derivative contracts with remaining maturity of more than one year.

73. We are concerned about the operational and cost burden this would have on the relevant market counterparties. The backloading of pre-existing contracts will involve substantial costs, without much regulatory benefit. This requirement will be onerous and technically difficult to achieve. If implemented, we would urge the MAS to build in a sufficient timeframe for compliance with such requirement and ensure that the backloading requirement is consistent with international standards.

Question 20: MAS seeks views on the proposal not to require reporting to domestic TRs only.

74. Members strongly support the proposal not to require reporting to domestic TRs only. This will allow market participants to leverage off existing market infrastructure and avoid unnecessary excessive cost.

75. However, we would strongly encourage the MAS not to impose the reporting mandate before appropriate foreign TRs are recognized under the proposed new regulatory framework for TRs. Alternatively, a "grandfathering" type provision could be implemented during the initial phase to allow certain foreign TRs to be eligible TRs prior to recognition under the proposed new regulatory framework.

5. TRADING MANDATE

Question 21: MAS seeks views on the proposal not to impose a trading mandate at this stage.

76. Members welcome the MAS's proposal not to impose a mandatory trading obligation at this stage. ISDA supports allowing participants to determine whether or not to trade on an organised trading platform. While increased use of trading platforms will bring benefits for particular derivative product types that are suitable for such venues, we believe that mandatory or incentivised use of such platforms where such products are not suitable to their use will not reduce risk and will negatively affect market participants and markets in general.

77. As the G20 recognised, it is not always appropriate for derivatives trading to take place on organised trading platforms even if the transactions have become relatively standardised. There are many differing models for negotiating and executing a derivative transaction and market participants should retain a choice between these different models to reflect their particular needs.

78. If mandating electronic trading or, for that matter, any type of trading requirement that is inflexible in its design and/or promoted too aggressively for products currently traded OTC, then the following risks could materialise :

(a) *The inability to customise*: Overly-ambitious promotion of a particular venue would likely concentrate trading activity in a subset of existing contracts, weakening the ability of market participants to customise contracts. More importantly, concentrating the market into a more narrow range of products linked to particular venues could potentially increase systemic risk, as clients would not have the ability to hedge and appropriately manage their unique risks.

(b) *(Associated) basis risk and earnings volatility*: If counterparties who wish to hedge are prevented from being able to enter into contracts that are customised to hedge the specific risks they face, they will face basis risk (a mismatch between the risks they face and the contracts they have to use), and earnings volatility, as it will be more difficult to qualify for hedge accounting treatment.

(c) *Loss of the means to manage risk*: The public transparency criteria associated with organised venues could prove problematic for market participants, particularly hedging counterparties, who could find the market more likely to move against them when they trade. For example, for some commodity contracts, where the number of participants is very low, disclosing the transaction, even on an anonymous basis, would be sufficient to identify the participants in the transaction and would not result in useful market information due to the specificity of the price.

A further reason for maintaining alternative methods of negotiating or executing trades is to allow for the possibility of significant drops in liquidity (such as where there is a jump in volatility). In those circumstances, market participants will wish to be able to seek out and negotiate with the available sources of liquidity on a bilateral basis. Constraints on their ability to do so will exacerbate market disruptions by restricting alternative sources of liquidity. For example, during the financial crisis there was a significant drop in volumes in standardised, plain vanilla exchange traded contracts.

(d) *Loss of market efficiency*: The unit size of OTC trades are typically larger than those on-exchange, reflecting (a) the professional nature of the market (exchanges often have a significant retail level of participation – at least for some types of instrument) and (b) the customised nature of the product (it is easier for counterparties to agree to one deal, than for a counterparty to have to purchase many units of smaller-denominated exchange-traded contract). Mandatory use of organised venues could therefore make risk transfer less efficient. At a minimum, regulators should make an independent assessment as to whether a swap should be executed on an organised trading platform separate from its clearing determination with respect to the same swap. In this respect, we note that under the Dodd-Frank Act, the fact that a swap is required to be cleared is not dispositive of whether such swap should be executed on a Swap Execution Facility.

79. We strongly believe that the MAS should allow participants to determine whether or not to trade on an organised trading platform. In the event that the MAS pursues the regulatory authority to impose a mandatory trading requirement, we would strongly caution against any rule that would mandate trading of all OTC derivatives on an organised platform, and would suggest that, at a minimum, the MAS makes an independent assessment as to whether a swap should be executed on an organised trading platform separate from its clearing determination with respect to the same swap.

80. We also refer the MAS to ISDA's submission to the CFTC on making swaps available to trade, a copy of which is attached in Appendix 2 to this letter.

Question 22: MAS seeks comments on the benefits and costs of introducing a trading mandate, taking into consideration the characteristics of the derivative markets in Singapore, and alternatives to a trading mandate, in moving derivative contracts to be traded on organized platforms.

81. Please see our response to Question 21 above.

6. PROPOSALS FOR THE REGULATORY FRAMEWORK FOR MARKET OPERATORS

Question 23: MAS seeks views on the proposed scope of the definition of "derivative market".

82. Given the proposal not to introduce the trading mandate at this stage, we would like to submit that it is premature at this state to introduce a regulatory framework for derivative market operators. We would suggest that this only be considered when the imposition of the trading mandate is proposed.

83. In any event, we would suggest that, while MAS has proposed to take a technology neutral approach in regulating the derivatives market, the MAS consider the global nature of electronic trading platforms and be mindful that the physical locations of where a bid, offer and acceptance of a transaction take place may be different.

Question 24: MAS seeks views on the proposal to extend the existing two-tier regulatory regime to derivative market operators.

84. We are concerned that the existing regulatory regime which applies to AEs and RMOs in the securities and futures markets may not be directly transferable on a wholesale basis to the derivatives market. Factors that are unique to the derivatives market should be taken into account. We suggest that the proposal for a regulatory framework for derivatives market operators be considered only in conjunction with the proposal for the introduction of a trading mandate.

Question 25: MAS seeks views on the proposed refinements of the RMO regime for locally-incorporated and overseas RMOs.

85. Generally, we are concerned about existing market operators based outside Singapore with no physical presence in Singapore (but who may offer investors in Singapore access through electronic means) being required to obtain RMO status with the MAS. In the absence of a fully-considered trading mandate, overseas market operators may be unaware or unprepared to fulfill the application requirements to become an RMO in Singapore.

7. PROPOSALS FOR THE REGULATORY FRAMEWORK FOR CLEARING FACILITIES

Question 26: MAS seeks views on the proposed amendment of the definition of "clearing facility" to include the clearing and settlement of derivative contracts.

86. Please see our response to Question 27 below.

Question 27: MAS seeks views on the proposed authorisation framework for clearing facilities.

CCP licensing and membership criteria

87. ISDA believes that requiring local clearing facilities to comply with CPSS-IOSCO standards[3] is an important additional criterion that should be imposed before granting a licence. CPSS-IOSCO is the most authoritative voice on CCP standards and meeting these standards would ensure that CCPs in Singapore meet or exceed international benchmarks for CCP management.

88. At the operational level, best practice CCP risk management starts with stringent requirements on becoming a clearing member ("**CM**") in terms of sufficient financial resources, robust operational capacity, and business expertise. We suggest that any CCPs in Singapore be required to adopt CM requirements that are clear, publicly disclosed, objectively determined, and commensurate with risks inherent in the cleared products and the obligations of CMs to the CCP.

89. CCPs typically seek to ensure that their CMs are creditworthy by establishing a set of financial requirements for membership. Usually CMs are required to meet, both initially and on an ongoing basis, minimum capital requirements, often stated as the larger of a fixed amount and a variable amount that depends on some measure of the scale and riskiness of the CM's positions with the CCP and in other financial markets. In most cases, membership is restricted to regulated entities that meet regulatory minimum capital requirements. CMs that carry client accounts are often required to meet capital standards that are more stringent than regulatory minimum requirements. Clearing membership should be non-discriminatory: Foreign market participants should be allowed to be CMs if they meet the publicly stated CM criteria.

[3] CPSS-IOSCO consultative report, Principles for Financial Market Infrastructures, March 2011 ("**CPSS-IOSCO Report**").

90. In addition to financial requirements, leading CCPs establish standards of operational reliability for CMs. CCPs typically impose tight deadlines for the submission of trade data and for completing various settlement obligations. The failure of a CM to meet these tight deadlines could significantly increase the CCP's risk exposures to that CM and possibly to other CMs as well. Compliance with operational deadlines must be closely monitored on a day-to-day basis. Furthermore, in recent years many CCPs have been paying greater attention to the backup systems that CMs would have available if their primary operating systems were disrupted.

91. CMs should only be able to introduce risk commensurate with their capital position. Further, entities that become CMs of OTC derivatives CCPs must have the ability to participate in the CCP default management process including the ability to bid for the portfolios of other CMs of the CCP. If a CCP admitted a CM (or a group of CMs) that was unable to participate fully in default management of the product it clears, there could be significant negative repercussions for the CCP and for the market. In particular, the unexpected failure of one or more CMs to participate in default management at a moment of severe stress for the CCP would reduce available resources and liquidity, place heightened burdens on other CMs, and reduce the likelihood that the CCP's risk management process would be effective. Moreover, for there to be the right level of incentives for active participation in default management, there needs to be enough 'skin in the game', which suggests not only that that the default fund needs to be allocated proportionally to risk introduced; but also that the default fund to initial margin ratio should reflect the estimated percentage of market risk remaining following the completion of the default management hedging phase.

Recognition of foreign CCPs

92. As a starting point for the recognition of foreign CCPs, we believe it is worth mentioning that it would be inappropriate to insist that foreign jurisdictions provide reciprocal recognition for CCPs based in Singapore when establishing a process for such recognition of foreign CCPs. This is because it would be likely to take a very considerable amount of time to implement such a reciprocal arrangement with foreign regulators, and if this process were not completed prior to the imposition of mandatory central clearing in Singapore, market participants might have no option but to arrange for its OTC derivatives transactions to be outside of the clearing regime in Singapore in order to avoid conflicting mandatory clearing obligations. This would have considerable negative consequences for the financial markets in Singapore.

93. We believe that it is imperative for the MAS to complete its process for recognition of foreign CCPs from certain major jurisdictions (such as the US and EU) at the same time that mandatory central clearing is implemented in Singapore in order for the affected entities subject to mandatory central clearing in both Singapore and abroad to have the ability to comply with both regimes.

94. However, if the application process under the SFA to be an ACH or RCH is a time-consuming process, we run the significant risk that some major foreign CCPs may not have become ACHs or RCHs when the mandatory clearing regime in Singapore takes

effect. This would be detrimental to the reputation of the regulatory regime in Singapore and would cause additional systemic risk to the OTC derivatives market in circumstances where certain banks with international operations were put in an impossible position with respect to the mandatory clearing regime imposed in Singapore because certain foreign CCPs had not yet achieved the status of an eligible CCP. Furthermore, any increased costs suffered by such banks would inevitably be borne by end-users in Singapore.

95. We would like to suggest that the MAS consider adopting a "grandfathering" approach whereby certain foreign CCPs, by virtue of their regulation by "acceptable overseas jurisdictions" in accordance with the principles set out under the CPSS-IOSCO Report, are provided a temporary licence to offer clearing services in Singapore as if they were an eligible CCP for the purposes of the mandatory clearing regime in Singapore without the need for such foreign CCP to have completed the process for licensing as an ACH or RCH in Singapore.

96. Members have also requested for more detail and further consultation on:

(a) What the proposed MOUs with home regulators will contain; and

(b) The details required to be set out in the self-assessment report to be provided by overseas RCHs.

Members are concerned:

(i) that there should not be restrictive legislation or regulatory requirements on foreign CCPs which could act as a disincentive for foreign CCPs to seek recognition under the proposed regulatory framework;

(ii) about the requirement that if the SFA imposes a higher standard than the home jurisdiction of the overseas RCH, the RCH will be required to comply with the higher standard. Members request that such standards need to be clearly defined and consistent with CPSS-IOSCO standards; and

(iii) whether the general requirements in paragraph 7.2.4 of the Consultation Paper and the requirement for MAS's approval for clearing fees are consistent with global requirements. If not, these may not be acceptable to foreign CCPs.

Question 28: MAS seeks views on the proposal to extend insolvency protection to all ACHs and RCHs.

97. We are supportive of the proposal to extend insolvency protection to all ACHs and RCHs. However, we would point out that overseas RCHs would be subject to the insolvency regime of their home jurisdiction and as such it is unclear how such extension of insolvency protection under the SFA would extend to overseas RCHs.

Client clearing issues

98. On a different but related point, we would like to take the opportunity to mention that an important way of ensuring that client clearing (which we submit is important given that non-financial entities will be subject to the clearing mandate) is successful in Singapore is to provide for special legislation which would ensure that, as a matter of Singapore law, client clearing arrangements, and in particular, the rules, and other arrangements, which apply on the default of a clearing member, would be enforceable in Singapore in accordance with their terms.

99. This is because, while the SFA provides that any actions taken by a Singapore clearing house under the rules of the CCP as they relate to clearing members, including under the default management procedures applicable to clearing members, will be protected from insolvency challenges and other attacks on enforceability, the SFA does not extend such protection to the contract between clearing members and the clients to whom they provide clearing services.

100. Accordingly, in circumstances where clients of a clearing member might seek to enforce the terms of their arrangements with a defaulting clearing member, such arrangements might be subject to the usual challenges which may arise on insolvency. While these challenges are similar to those which may apply to other contractual arrangements (including collateral arrangements) in Singapore, the result of this is that while, as a matter of Singapore law, there will be full settlement finality in respect of the arrangements between the Singapore clearing house and any defaulting clearing member, the clients of such clearing member will not have similar protections.

101. It should be noted that, in comparison to, for example, the EU which has the Financial Collateral Directive (2002/47/EC) and associated implementing legislation in European member states, Singapore does not currently have any equivalent legislation in respect of financial collateral arrangements which provides for special protection to be given to financial collateral arrangements, including protection from insolvency challenges.

102. Accordingly, we would like to suggest that the MAS consider extending similar legislative protections to client clearing arrangements as those which apply under the SFA to the arrangements between a CCP and its clearing members.

103. It should be noted that while such protections could be applied to prevent insolvency or other enforceability challenges being brought in a Singapore court, the cross-border nature of the relationship between clients and clearing members may mean that, for example, as a matter of the conflict of laws, other laws (for example the law governing any insolvency proceedings of a defaulting clearing member) may be relevant to the determination of whether client clearing arrangements are enforceable. If this is the case, then any Singapore legislation may not be able to give full protection to clients, however, it could help to protect clients from any challenges being brought in Singapore courts.

104. Amongst other things, such legislation might provide for:

(a) the protection of client clearing arrangements against insolvency challenges;

(b) the removal of any restrictions on enforcement of client clearing arrangements in insolvency situations;

(c) where necessary, confirmation of rights of close-out netting and set-off between parties;

(d) the removal of formalities in respect of the creation of collateral rights; and

(e) where relevant, clarification of conflicts of law issues in respect of collateral over book entry securities.

105. The existence of such legislation might greatly assist market participants to give confidence to potential clients that the client clearing arrangements of the Singapore CCP which are designed to protect clients from the insolvency of clearing members will be enforceable under the laws of Singapore.

106. Members would like, however, to emphasise the importance of tracking international standards in connection with client clearing, particularly where local CCPs are proposing to introduce client clearing arrangements. Members encourage the MAS to monitor the technical debate on detailed authorisation requirements in the US and EU and that careful consideration be given to issues such as internal governance and risk management frameworks, default mechanisms (including default fund contributions), protection of client collateral and portability, transparency of rules and procedures, participation in the extension of business to new products, margin methodology and segregation structures.

8. PROPOSALS FOR THE REGULATORY FRAMEWORK FOR TRADE REPOSITORIES

Question 29: MAS seeks views on the proposed definition of trade repositories to be regulated under the SFA.

107. We have no objection to the proposed definition of trade repositories.

Question 30: MAS seeks views on the proposed authorisation framework for trade repositories, including whether to impose minimum base capital requirements and governance standards on trade repositories.

108. We would recommend that standards for trade repositories as set out in the CPSS-IOSCO Report be followed as much as possible.

109. We welcome the proposal to allow trade reporting to overseas trade repositories. However, there is concern as to how ROTRs will be authorised and the extent of local regulation of ROTRs. We urge the MAS to further consult market participants when more detailed proposals regarding the regulation of ROTRs are available.

110. We urge the MAS to avoid restricting recognition to overseas trade repositories whose home regulators reciprocate recognition under their own regulations. This would unduly

restrict the ability of market participants to use TRs which meet all other objective standards.

111. Members have also requested for more detail and further consultation on:

(a) What the proposed MOUs with home regulators will contain; and

(b) The details required to be set out in the self-assessment report to be provided by ROTRs.

Members are concerned:

(i) that there should not be restrictive legislation or regulatory requirements on foreign TRs which could act as a disincentive for foreign TRs to seek recognition under the proposed regulatory framework;

(ii) about the requirement that if the SFA imposes a higher standard than the home jurisdiction of the ROTR, the ROTR will be required to comply with the higher standard. Members request that such standards need to be clearly defined and consistent with CPSS-IOSCO standards; and

(iii) whether the requirements in paragraph 8.2.2 of the Consultation Paper are consistent with global requirements. If not, these may not be acceptable to foreign TRs.

Question 31: MAS seeks views on the proposal to not require foreign regulators to provide indemnification to an ATR/ROTR and MAS prior to obtaining data from the ATR/ROTR.

112. We have no objection to this proposal. In this regard, the MAS should also take into account the developments in the US whereby provisions for indemnification have been questioned and legislative steps have been taken to remove this provision.

9. PROPOSALS FOR THE REGULATORY FRAMEWORK FOR CAPITAL MARKETS INTERMEDIARIES

Question 32: MAS seeks views on:

(i) the proposal to regulate non-bank intermediaries dealing in derivative contracts as CMS licensees under the SFA; and

113. Please see our response to Question 1 above.

114. We would like to reiterate the point that unlike the securities market where retail investors not only form a significant group of market participants but are often the target market of a securities offer, trading in OTC derivatives occurs almost exclusively among counterparties that would be considered "wholesale". Unlike futures contracts which are standardized contracts specified by the relevant exchange and where parties assume exposure not to each other but to the clearing house of such exchange, OTC derivatives

are customized, bilaterally negotiated contracts between the parties where each assumes exposure to the other (but usually, the parties enter into bilateral margining arrangements to collateralize or secure their exposures to each other). A fundamental tenet is that parties to an OTC derivative transact on a principal-to-principal basis and at arm's length. OTC derivatives markets also tend to be global in nature, that is, cross-border transactions between parties in two different countries are common. Given the very different nature of the market-place for securities, futures contracts and OTC derivatives, a regulatory regime that may be appropriate for securities and futures contracts would not be appropriate for OTC derivatives.

115. As it is common in the Singapore market for market participants to book OTC derivative transactions to their head office or offshore branches or affiliates, members have queried if an exemption similar to that under paragraph 9 of the Third Schedule to the SFA ("**Para 9 Exemption**") could apply (whether to banks and/or non-bank intermediaries). It is also submitted in the alternative that many of such arrangements are already known to the MAS through the supervisory process or inspections, where the traders are based in banks or merchant banks in Singapore regulated by the MAS. In many instances, the MAS already has the ability to supervise the trading activities even if the trades are booked offshore. We propose that the MAS consider not subjecting the foreign entities under such circumstances to extra-territorial provisions under the SFA which introduces unnecessary additional licensing burden and costs.

116. We urge the MAS to further consult market participants when more detailed proposals are available.

117. We note that paragraph 9.1.1 of the Consultation Paper refers to "banks licensed under the Banking Act" and "non-bank intermediaries". We assume the MAS intended for the former to also include a reference to merchant banks licensed under the Monetary Authority of Singapore Act ("**MAS Act**") and that merchant banks will continue to be regulated as is under the MAS Act.

(ii) the proposed scope of activities for dealing in derivative contracts.

118. Please see our response to Question 32(i) above.

119. In particular, we urge the MAS to consider applying exemptions from licensing and/or conduct of business rules where appropriate and relevant to the OTC derivatives market, taking into consideration the nature of the OTC derivatives market and its contracts. For example, where appropriate, exemptions when dealing with certain classes of participants (e.g. accredited investors) or where transactions are booked in a certain manner (e.g. with offshore branches or affiliates under an exemption similar to the Para 9 Exemption) should be made available.

120. With respect to footnote 25 to paragraph 9.1.2 of the Consultation Paper, members urge the MAS to allow leveraged foreign exchange trading by banks to continue to fall outside the ambit of the SFA as such transactions constitute foreign exchange trading on a margin basis rather than OTC derivatives contracts.

Question 33: MAS seeks views on the proposed exemption for derivative brokers.

121. We express no view on this proposal, other than to request that any exemption should not create an unlevel playing field for market participants.

Question 34: MAS seeks views on the proposal not to regulate end-users as CMS licensees under the SFA.

122. We believe that affordable access to appropriate methods of hedging, including the use of OTC derivatives, is vital to end-users as they seek to mitigate risks and maintain their economic viability. We caution against implementing regulation that would make access to these critical risk management tools either too difficult or too expensive to attain.

123. We urge that the definition of end-users be carefully considered to ensure that an unlevel playing field for market participants is not created as a result of any exemption. Not all end-users are the same - some end-users may in fact act as market makers or price-makers. This is perhaps more pronounced in relation to commodity derivatives where the major market participants include banks and non-bank commodity traders and commodity producers. We would like further consultation on the definition of end-users once this is available.

ISDA appreciates the opportunity to provide comments on the Consultation Paper and looks forward to working with the MAS as it continues the regulatory process. If you have any questions on this submission, please feel free to contact the undersigned at your convenience.

Yours faithfully,
For the International Swaps and Derivatives Association, Inc.

Keith Noyes
Regional Director, Asia Pacific

Jacqueline ML Low
Senior Counsel Asia

APPENDIX 1

A. ISDA's submission to the SEC – Notice of Proposed Rulemaking: Process for Review of Security-Based Swaps for Mandatory Clearing dated February 14, 2011

ISDA®

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February 14, 2011

Elizabeth M. Murphy
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: RIN 3235-AK87 - Notice of Proposed Rulemaking: Process for Review of Security-Based Swaps for Mandatory Clearing (75 Fed. Reg. 82490)

Dear Ms. Murphy:

This letter contains the response of the International Swaps and Derivatives Association, Inc. ("ISDA") to the Securities and Exchange Commission's (the "Commission") notice of proposed rulemaking ("NPR") regarding the process for the review of security-based swaps for mandatory clearing, as required by Section 763(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

ISDA is the largest global financial trade association, by number of member firms. ISDA was chartered in 1985, and today has over 800 member institutions from 54 countries on six continents. These members include most of the world's 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 ("OTC") derivatives to manage efficiently the financial market risks inherent in their core economic activities.

Since its inception, ISDA has pioneered efforts to identify and reduce the sources of risk in the derivatives and risk management business through documentation that is the recognized standard throughout the global market, legal opinions that facilitate enforceability of agreements, the development of sound risk management practices, and advancing the understanding and treatment of derivatives and risk management from public policy and regulatory capital perspectives.

At the outset, we wish to be clear that ISDA supports clearing for a wide range of liquid standardized[1] derivatives and wishes to work with the Commission to implement the mandatory clearing[2] of OTC derivatives required under the Dodd-Frank Act in a way that will enhance market liquidity and financial stability.

ISDA commends the Commission for its careful consideration in the NPR of the issues raised by the mandatory clearing provisions of the Dodd-Frank Act. ISDA has a number of comments on this important rule proposal and welcomes this opportunity to share these with the Commission. ISDA looks forward to assisting the Commission and its staff in implementing an appropriate framework for mandatory clearing, consistent with the standards set forth in the Dodd-Frank Act, with a view to enhancing market liquidity, reducing risk and fostering financial stability.

Background

The Dodd-Frank Act amended the Securities Exchange Act ("SEA") to require the Commission to adopt rules for determining whether a security-based swap, or group, category, type or class of security-based swaps (collectively, "security-based swaps") should be required to be cleared.

This letter contains two parts. The first covers ISDA's comments in relation to the proposed rules governing the Commission's review of security-based swaps in order to determine whether to impose a mandatory clearing requirement (whether the reviews are Commission-initiated or arise from a clearing agency submission). The second covers ISDA's comments in relation to the Commission's power to stay the clearing requirement.

1. The Commission's review of a security-based swap submission to determine whether to impose a mandatory clearing requirement

The Commission review contemplated by these provisions is, of course, extremely consequential. If the relevant clearing solution fails to establish an operationally sound and robust risk management framework, or captures an inappropriate category of security-based swaps, the consequences for the clearing agency and for the market could be significant.

An ineffective clearing agency risk management framework could have systemic implications and could deter market participants from transacting in the relevant security-based swap(s). The inappropriate imposition of mandatory clearing requirements could

[1] For the avoidance of doubt, we use "standardized" here in the sense detailed on page 4 of this letter. We do not consider that the degree of standardization necessary for exchange trading is necessary for clearing.
[2] We recognize that the NPR contemplates that the determination of whether a clearing agency is eligible to clear a security-based swap is related to, but separate from, a determination as to whether such security-based swap is subject to a mandatory clearing requirement. Our letter focuses primarily on the mandatory clearing requirement.

also adversely affect liquidity in the relevant security-based swap(s) and similarly deter use of otherwise optimal risk management products. While sound, centralized clearing affords clear benefits, it should be noted that centralized clearing also entails increased operational and collateral costs. As a result, it is important that the Commission strike an appropriate balance in evaluating the relevant statutory standards applicable to a mandatory clearing determination, and weigh the relevant factors and market impacts with great care.

Definitional Considerations

The Dodd-Frank Act and proposed Commission rules refer variously to "security-based swaps", "categories" of security-based swaps, "classes" of security-based swaps, "types" of security-based swaps and "groups" of security-based swaps. The meaning and scope of each of these references is critical to understanding the scope of a Commission determination that mandatory clearing applies (i.e., precisely which security-based swaps are affected). It is equally critical to a complete and accurate evaluation of the statutory factors that are to be considered in connection with a mandatory clearing determination. This is reflected in the statutory factors requiring the Commission to consider: the availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded.

It is important that the determination that a product is 'clearable' includes the requirement that the terms and conditions of such clearing, and the terms and conditions of the cleared security-based swap after novation to the clearing agency do not involve the introduction of terms or conditions that cause the cleared product to differ in material respects from the product that is commonly traded in the market. Otherwise the imposition of a mandatory clearing requirement will, among other consequences, introduce basis risk for clearing members. In addition, the attributes (including liquidity and current and historical price) of the cleared products may differ substantially from the traded product in ways that will also contribute to increased risk and adversely impact market liquidity.

Accordingly, the Commission's definition of products subject to the mandatory clearing requirement must be as clear and specific as possible. By way of example, in the context of security-based swaps, the product definition should include at least the following characteristics (to the extent applicable):

(i) instrument description (for example, vanilla single stock swap with constant notional principal);
(ii) acceptable currencies (and whether the contract is single currency);
(iii) acceptable indices;
(iv) types (for example, total return or price return);
(v) maximum residual term;
(vi) notional amount (minimum to maximum of the relevant currency unit);
(vii) applicable day count fraction (for example, Actual/365 or Actual/Actual);

(viii) applicable business day convention;
(ix) minimum residual term of the trade (i.e., the period from the date of submission of the trade to the date of termination); and
(x) applicable calculation periods (for example, “stub periods”).

For CDS, the reference entity and transaction type (including whether senior/subordinated, coupon, and the credit events covered) would also be required. For equity swaps, additional characteristics for the Commission to consider include acceptable Exchanges, Quantity, specify Floating Rate Option, any Dividend provisions, and whether to specify Extraordinary Events and Additional Disruption Events and their consequences.

This precision of definition is necessary because instrument liquidity can vary dramatically with tenors or if other changes are made to the contractual terms (even if these changes appear small). Thus in order to guarantee that only those instruments of sufficient liquidity to ensure clearing agency robustness are within the scope of mandatory clearing, the Commission should draw that scope precisely. To that end, key terms such as “category,” “group,” “class” or “type” of security-based swap need further definition.

It should also be noted that the cost for clearing agencies and security-based swap counterparties is increased where higher levels of uncertainty in relation to the applicability and risk of a clearing obligation exist. This would suggest an early and narrow definition of the mandatory clearing requirement and a reasonable transition period to allow market participants to comply with the new clearing requirements are appropriate. In addition, we wish to confirm that the Commission intends that a clearing agency ‘eligibility to clear’ review is to be separate from and precede a security-based swap mandatory clearing review and it is not intended that both reviews can commence simultaneously. As noted, the time for reviews is short and thus a specific focus and timeframe for each review is sensible. Finally, a further transition period between the implementation of the mandatory clearing requirement and the application of any security-based swap execution facility/trading requirements is also suggested.

The Five Factors of the Dodd-Frank Act

We welcome the Commission’s acknowledgement in its proposed rule that the following five factors outlined in Section 763(a) of the Dodd-Frank Act[3] should be the basis for the Commission’s determination:

(I) The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data.

Some types of security-based swaps (for example single stock equity swaps on major index components in standard tenors and structures) have a ready market of buyers and sellers, as

[3] See Section 3C of the SEA.

evidenced by bids and offers that change throughout a trading day. By contrast, non-standard structures and tenors are frequently tailored to a counterparty's risk management needs and thus may be less liquid; for example, a bespoke equity swap on a mid-cap stock provided to give an investor a tailored exposure to a particular equity. Given the illiquid nature of this product, it may be difficult to obtain daily market prices for it. Bespoke security-based swaps like these are common, but clearing them would give rise to significant model and parameter risks due to the need for a models-based valuation, which could in turn concentrate systemic risk in the clearing agency itself.

It is critical that a clearing agency has the capacity and expertise needed to manage all of the risks associated with the products that it clears. These risks include potential valuation error, which can in turn lead to errors in estimates of initial or variation margin requirements and/or guaranty fund obligations. Since margin must be calculated at least daily, and since daily (or more frequent) market prices form the best basis for valuation, the availability of daily market prices for cleared products must be assured in all market conditions, including stressed markets. This is key since, if the amount held as margin turns out to be inadequate to cover the liquidation of a portfolio, then the clearing agency itself may be endangered.

Liquidity is also an important consideration in applying the mandatory clearing requirement because of the statutory linkage between mandatory clearing and mandatory trade execution on designated contract markets and security-based swap execution facilities.

Based on the foregoing, it is clear that the size of the relevant security-based swap market and its depth are crucial properties in the determination of the scope of mandatory clearing, and a conservative interpretation is required here. ISDA would be happy to provide expertise to assist the Commission in developing the appropriate measure of liquidity required for clearing, for mandatory clearing, and for contract market/SEF execution across particular products.

(II) *The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded.*

This addresses two important and related points. First, it reinforces the importance of the consideration that the Commission must make under the core principles in assessing the financial integrity and operational competence of a clearing agency. In this context, the Commission's determination must also take into account, in assessing the enumerated factors, whether these factors can be satisfied by the clearing agency given the potential volumes which it would clear under a mandatory clearing requirement.

Second, the evaluation should be premised on the determination that the terms and conditions of the cleared security-based swaps and the terms and conditions on which they are cleared are consistent with the material terms and trading conventions on which the relevant security-based swaps are then traded. In this regard, we highlight that there is significant variability among security-based swap agreements. In comparison to other asset classes, equity swaps often have more complex terms and trading conventions due to the possibility of lifecycle events (for example, splits, dividends, spinoffs, mergers, etc.). This inherent and significant variability among equity swaps will increase the complexity of clearing equity swaps.

These determinations are essential to ensure that the imposition of a mandatory clearing obligation for security-based swaps will, in practice, actually achieve the statutory objectives of increasing market liquidity and reducing risk in the financial system rather than increasing it.

(III) *The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the clearing agency available to clear the contract.*

Like the preceding factors, this factor is intended to examine whether a mandatory clearing requirement with respect to the relevant security-based swap would decrease systemic risk. This, in turn, requires an assessment of the size of the market for the relevant security-based swap, the risk attributes of the security-based swap, the scope and risk profile of other products cleared by the clearing agency, and the aggregate amount (and terms of availability) of the clearing agency's financial and credit support resources. Other risks, such as settlement and operational risks that can contribute to a clearing failure must, of course, also be considered. Finally, the current and likely future importance of a clearing agency to the market it serves must be considered together with the extent to which the failure of a clearing agency will itself contribute meaningfully to systemic risk.

(IV) *The effect on competition, including appropriate fees and charges applied to clearing.*

This issue is important as while competition is essential, it also exposes clearing agencies to new risks. Thus an assessment of a clearing application should address the potential conflict of interests between owners and management of clearing agencies and the wider financial system with particular sensitivity to risk management standards.

Here regulation has an important role in correcting the effect whereby low margin and guaranty fund levels may win a clearing agency business in the short term at the expense of wider financial stability. Lower margin and guaranty fund requirements should only be allowed where the Commission is confident that a clearing agency possesses sufficient alternative resources to support itself to a robust standard and where such a reduction does not materially increase systemic risk.

Finally, prudence would suggest that the Commission take into account competitive implications of the timing of imposing a mandatory clearing requirement in the light of the manner in which the distribution of open interest significantly constrains effective competition between clearing agencies.

(V) *The existence of reasonable legal certainty in the event of the insolvency of the relevant derivatives clearing organization or one or more of its clearing members with regard to the treatment of customer and security-based swap counterparty positions, funds, and property.*

Financial stability requires legal certainty of outcome in insolvency. This is essential to ensuring, that, upon insolvency, the assumptions on which credit support levels and default management procedures were structured are well founded and reliable. It is also essential in order to mitigate concerns that may deter participation in the market or in available clearing solutions. In particular, confidence in the portability of customer accounts upon the insolvency of a clearing member is extremely important to market participants.

As a related point, it is imperative that a comprehensive structure to address possible clearing market stress which might, if not mitigated, lead to clearing member or clearing agency insolvency is promulgated by the Commission in consultation with other stake holders. There are a number of requirements here:

(i) a general supervisory framework for clearing agency resolution. This framework, in conjunction with the rules of the relevant clearing agencies, is a critical requirement as market clarity is required on their resolution/bankruptcy regime;

(ii) for each clearing agency, a specific plan to address possible future stress. Such a plan might include consideration of whether an alternative clearing agency is able to clear a particular product prior to a determination of a mandatory clearing obligation for that product. This is important given that a clearing agency may be the principal venue for clearing a product and, in the absence of adequate continuity planning, clearing agency stress might preclude the functioning of the market for that product;

(iii) finally, it is important to note that both Clearing Member ("CM") insolvency and clearing agency stress resolution have potential cross border aspects so clarity is also required on these matters.

The five criteria of the Act, if taken together and conservatively applied, make it highly likely that a clearing agency will be able to value, call for margin on, and risk manage all cleared products. Therefore we encourage the Commission to interpret these criteria strictly, and only to mandate clearing for a particular product where they are clearly met at the time of the relevant application, and are highly likely to continue to be met in the future, including during future stressed periods. Such an approach will ensure adequate clarity and decrease the risk of inconsistent impositions of the clearing obligation. The Dodd-Frank Act provides the Commission with ample discretion and thus allows it to carry out its responsibilities in an efficient and prudent manner without the need to interpret these criteria loosely.

Given the importance of these criteria, we would welcome clarification from the Commission that these criteria will form the basis of Commission reviews undertaken as a result of a clearing agency security-based swap submission.

We now go on to note some further issues relating to the Commission's review of security-based swap submissions.

Additional Considerations

Standardization: For the avoidance of doubt, ISDA agrees with G-20 Leaders' position expressed in Pittsburgh in September 2009 that many types of standardized products should be eligible for clearing. ISDA considers that there are three elements to be considered in relation to standardization:

(i) *Legal uniformity*: this includes standard transaction documentation and definitions. A product's documentation will be sufficiently standardized if legal definitions exist, if participants have only a discrete number of documentation options to choose from, the security-based swap is documented using market standard documents and definitions, if there is legal certainty of contract, and if the effects of default (and other life events) are well established and apply uniformly across the market.

(ii) *Process uniformity* (automation): this includes straight-through-processing facilitating the matching of confirmations, settlement and event handling. Electronic confirmation is the surest means of ensuring a contract exists and that a party is not subject to legal uncertainty because of delays in confirmation or lack of standardization in contractual terms.

(iii) *Product uniformity*: including standard valuation, payment structures, dates and determination of life cycle events. Conventions should be in place to govern how the product is traded, and existing industry practice should always be strongly preferred to novel arrangements. There should be a simple procedure for trading the product based on a "normal" transaction type. Industry practice here refers to events that might occur while the product is outstanding: rate resets, defaults, corporate actions, etc. All of these events should create effects that are well-known to and understood by market participants. In every case, product standardization should be driven by market needs, practices and priorities.

Mandatory clearing exceptions: On a related issue, ISDA believes certain transactions, otherwise eligible for clearing, should not be subject to mandatory clearing. We encourage the Commission to document the scope of these exceptions so that firms have clarity on when they apply.

The most obvious and prevalent concern involves trades where the derivative eligible for clearing would reduce counterparty risk if executed on a bilateral basis. Such trades often involve cases where the clearable trades ("A Trades") are hedges to unclearable trades ("B Trades"), and both trades are with the same counterparty. More specifically, we consider there to be two types of possible exceptions for A Trades:

(i) where the B Trades are likely to be clearable in the future
(ii) where the B Trades are unlikely to be clearable in the future.

The first type of exception would be necessary until the B Trades become clearable. For the second type of exception central clearing is never appropriate so the exception would last to the maturity of the trade.

More generally if clearing a clearable trade results in a material increase in counterparty risk, then this trade should be eligible for an exemption to mandatory clearing. This will often happen when a clearable trade hedges or partially offsets a particular non-clearable trade as discussed above, but there may be other instances of this phenomenon[4].

Affiliate (intra-group) transactions: Another situation where an exemption for eligible trades to mandatory clearing is appropriate concerns intra-group transactions. Transactions between affiliates allow entities within a corporate group to manage their overall risk more efficiently. Here central clearing would simply introduce further intra-group transactions (since it is likely that neither of the counterparties is the group CM) and thus forcing mandatory clearing in this situation would likely have no benefit in risk reduction, nor in decreasing the number of intra-groups trades. Moreover the associated initial margin requirements would result in an unnecessary consumption of group liquidity. Thus we recommend an exemption from mandatory clearing requirements for all intra-group transactions.

Wrong way risk: The Commission's determination in relation to the security-based swap submissions must be sensitive to "wrong way risk", namely the risk that different risk factors be correlated in the most harmful direction.

Implementation timing: ISDA considers that two transition periods, one from when a determination is made that a security-based swap is subject to a "mandatory clearing requirement" to when such "mandatory clearing requirement" takes effect, the other from when a determination is made that a security-based swap is subject to an "exchange or security-based swap execution facility trading" requirement to when such requirement takes effect, are necessary to sensibly reflect the work required and risks involved in moving a product to central clearing and to trading venues. From a practical perspective, market participants will need sufficient time to conduct due diligence on any new clearing agencies/trading venues and put in place the necessary operational systems, processes and legal documentation in order to connect to such clearing agencys/trading venues. Accordingly, we recommend that the Commission consider an extended period between a

[4] Security-based swap dealers manage their counterparty risk to each other, and to other counterparties, in part using active portfolio management techniques. Thus if one or more unclearable trades exist between two parties, it may be decided to enter into a transaction which would reduce counterparty risk. This portfolio-risk-reducing trade may be clearable. However, requiring it to be cleared would evidently be counterproductive as it only reduces risk if executed on a bilateral basis. Therefore mandatory clearing of such trades would deprive dealers of a valuable risk mitigation tool.

determination being made that a security-based swap is required to be cleared and clearing becoming mandatory on that product. This period would provide market participants the opportunity to make themselves appropriately ready to clear mandated transactions without risking either (i) disruption to their use of derivatives for hedging or (ii) noncompliance with the law. Similarly we recommend a second transition period from when the "exchange/security-based swap execution facility trading" requirement is determined to when such requirement takes effect in order to ensure that a stable and competitive market has time to develop. Further, ISDA would recommend full transparency of clearing agency requirements and performance during any such period(s). This will provide important notice and information for affected parties on what the relevant margin and guaranty fund calculations will be, what pricing requirements will be set by the clearing agency, how default management will operate, and to connect the relevant platforms and systems.

In addition and more specifically, the NPR states that the public review period will be at least 30 days and the Commission's total review time is 90 days (though this may be extended with the consent of the clearing agency making the security-based swap submission). First, we suggest that the Commission extend the minimum public review period to 45 days. Second, this public review period should only commence after:

(i) the clearing agency has proven the ability to clear the product through testing;
(ii) the clearing agency has sufficient operational resources and established connectivity to the market using standard protocols;
(iii) all market standardization issues defining the product, life events, etc. have been resolved;
(iv) pricing standards and margin calculations have been agreed by the clearing agency's risk committee; and
(v) the Commission has all the information it needs and (in respect of a clearing agency submission) this information has been verified as consistent with data from security-based swap data repositories, security-based swap dealers and major security-based swap participants.

This process would address the risk that much of the information in the submission on which the Commission bases its determination of whether a security-based swap is required to be cleared is provided by the clearing agency and the clearing agency has an economic interest in the particular security-based swap being subject to mandatory clearing.

Moral hazard concerns: In a circumstance where no clearing agency offers clearing services for a particular product, there are practical difficulties resulting from a Commission decision that mandatory clearing applies. Indeed, a determination of mandatory clearing in such a circumstance raises moral hazard concerns, as it may have the effect of requiring market participants to use a clearing agency despite their risk appetite.

2. Stay of the clearing requirement and review by the Commission

Section 763(a) of the Dodd-Frank Act provides the Commission the authority to stay the mandatory clearing requirement on application of counterparty to a security-based swap or on the Commission's own initiative. We consider this to be an important provision as there are many circumstances under which the Commission should exercise this authority, some of which are discussed above. Further examples involve circumstances in which there is an absence of competition, or where there is an unresolved clearing member default at the only clearing agency then clearing the relevant product. Yet another, but important, example exists in circumstances where the Commission determines to impose a mandatory clearing requirement in a situation where a clearing agency has not elected to clear the product. As noted above, there are systemic risk implications where clearing agencies are allowed to clear products which they have not positively chosen to clear.

Finally, if a product subject to mandatory clearing becomes so illiquid as to threaten the clearing agency's ability to calculate margin or to manage a default, then a stay of the clearing requirement for that product may be necessary.

Conclusion

The public policy rationale for the Dodd-Frank Act is to reduce risk, increase transparency and promote financial market stability by, inter alia, imposing a clearing requirement on security-based swaps when the Commission determines that such requirement would be consistent with the five factors specified in the Dodd-Frank Act. ISDA believes that public policy is best served by the Commission interpreting these criteria strictly given the risks and alternatives tools available.

ISDA appreciates the opportunity to provide these comments. Should you require further information, please do not hesitate to contact the undersigned.

Sincerely,

Robert G. Pickel

Robert Pickel
Executive Vice Chairman

ISDA

B. ISDA's submission to the CFTC – Notice of Proposed Rulemaking: Process for Review of Swaps for Mandatory Clearing dated December 22, 2010

ISDA®

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December 22, 2010

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: RIN 3038-AD00 - Notice of Proposed Rulemaking: Process for Review of Swaps for Mandatory Clearing (75 Fed. Reg. 67277)

Dear Mr. Stawick:

This letter contains the response of the International Swaps and Derivatives Association, Inc. ("**ISDA**") to the Commodity Futures Trading Commission's (the "**Commission**") notice of proposed rulemaking ("**NPR**") regarding the process for the review of swaps for mandatory clearing, as required by Section 745 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank Act**").

ISDA is the largest global financial trade association, by number of member firms. ISDA was chartered in 1985, and today has over 830 member institutions from 57 countries on six continents. These members include most of the world's 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 ("**OTC**") derivatives to manage efficiently the financial market risks inherent in their core economic activities.

Since its inception, ISDA has pioneered efforts to identify and reduce the sources of risk in the derivatives and risk management business through documentation that is the recognized standard throughout the global market, legal opinions that facilitate enforceability of agreements, the development of sound risk management practices, and advancing the understanding and treatment of derivatives and risk management from public policy and regulatory capital perspectives.

At the outset, we wish to be clear that ISDA supports clearing for a wide range of liquid standardized[1] derivatives and wishes to work with the Commission to implement the mandatory clearing[2] of OTC derivatives required under the Dodd-Frank Act in a way which will enhance market liquidity and financial stability.

ISDA commends the Commission for its careful consideration in the NPR of the issues raised by the mandatory clearing provisions of the Dodd-Frank Act. ISDA has a number of comments on this important rule proposal and welcomes this opportunity to share these with the Commission. ISDA looks forward to assisting the Commission and its staff in implementing an appropriate framework for mandatory clearing, consistent with the standards set forth in the Dodd-Frank Act, with a view to enhancing market liquidity, reducing risk and fostering financial stability.

Background

The Dodd-Frank Act amended the Commodity Exchange Act ("**CEA**") to require the Commission to adopt rules for determining whether a swap, or group, category, type or class of swaps (collectively, "**swaps**") should be required to be cleared and to prescribe criteria, conditions, or rules under which the Commission will determine the initial and ongoing eligibility of a derivatives clearing organization ("**DCO**") to clear swaps.

Accordingly, this letter contains two parts. The first covers ISDA's comments in relation to the proposed rules governing the Commission's review of swaps in order to determine whether to impose a mandatory clearing requirement (whether the reviews are Commission-initiated or arise from a DCO submission or deemed submission). The second covers the rules for the review of initial and ongoing eligibility[3] of DCOs to clear swaps.

1. The Commission's review of swaps to determine whether to impose a mandatory clearing requirement

The Commission review contemplated by these provisions is, of course, extremely consequential. If the relevant clearing solution fails to establish an operationally sound and robust risk management framework, or captures an inappropriate category of swaps, the consequences for the DCO and for the market could be significant.

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[1] For the avoidance of doubt, we use "standardized" here in the sense detailed on page 4 of this letter. We do not consider that the degree of standardization necessary for exchange trading is necessary for clearing.
[2] We recognize that the NPR contemplates that the determination of whether a DCO is eligible to clear a swap is related to, but separate from, a determination as to whether such swap is subject to a mandatory clearing requirement. Our letter focuses primarily on the mandatory clearing requirement.
[3] We note that, understandably, the NPR focuses on determinations relating to the initiation of clearing (or mandatory clearing). We respectfully recommend that the Commission also address the rules and processes under which a DCO ceases to meet the relevant standards for clearing, or under which mandatory clearing is no longer appropriate. ISDA would be pleased to make representatives available to Commission staff to discuss appropriate measures for addressing scenarios such as these.

An ineffective DCO risk management framework could have systemic implications and could deter market participants from transacting in the relevant swap(s). The inappropriate imposition of mandatory clearing requirements could also adversely affect liquidity in the relevant swap(s) and similarly deter use of otherwise optimal risk management products. While sound, centralized clearing affords clear benefits, it should be noted that centralized clearing also entails increased operational and collateral costs. As a result, it is important that the Commission strike an appropriate balance in evaluating the relevant statutory standards applicable to a mandatory clearing determination, and weigh the relevant factors and market impacts with great care.

Definitional Considerations

The Dodd-Frank Act and proposed Commission rules refer variously to "swaps", "categories" of swaps, "classes" of swaps, "types" of swaps and "groups" of swaps. The meaning and scope of each of these references is critical to understanding the scope of a Commission determination that mandatory clearing applies (i.e., precisely which swaps are affected). It is equally critical to a complete and accurate evaluation of the statutory factors that are to be considered in connection with a mandatory clearing determination. This is reflected in the statutory factors requiring the Commission to consider: the availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded.

It is important that the determination that a product is 'clearable' includes the requirement that the terms and conditions of such clearing, and the terms and conditions of the cleared swap after novation to the DCO do not involve the introduction of terms or conditions that cause the cleared product to differ in material respects from the product that is commonly traded in the market. Otherwise the imposition of a mandatory clearing requirement will, among other consequences, introduce basis risk for clearing members. In addition, the attributes (including liquidity and current and historical price) of the cleared products may differ substantially from the traded product in ways that will also contribute to increased risk and adversely impact market liquidity.

As a corollary, when a swap, type, class, group or category of swap is identified as subject to a mandatory clearing requirement, the scope of that requirement must be defined by reference to the specific material terms that govern the clearing, and the terms and conditions, of the relevant swap(s) following novation to the DCO.

Accordingly, the Commission's definition of products subject to the mandatory clearing requirement must be as clear and specific as possible. By way of example, in the context of rate swaps, the product definition should include at least the following characteristics (to the extent applicable):

(i) instrument description (for example, vanilla interest rate swaps with constant notional principal);
(ii) acceptable currencies (and whether the contract is single currency);
(iii) acceptable indices;
(iv) types (for example, fixed vs. floating or floating vs. floating);
(v) maximum residual term;
(vi) notional amount (minimum to maximum of the relevant currency unit);
(vii) applicable day count fraction (for example, Actual/365 or Actual/Actual);
(viii) applicable business day convention;
(ix) minimum residual term of the trade (i.e., the period from the date of submission of the trade to the date of termination); and
(x) applicable calculation periods (for example, "stub periods").

For CDS, the reference entity and transaction type (including whether senior/subordinated, coupon, and the credit events covered would also be required).

This precision of definition is necessary because instrument liquidity can vary dramatically with tenors or if other changes are made to the contractual terms (even if these changes appear small). Thus in order to guarantee that only those instruments of sufficient liquidity to ensure DCO robustness are within the scope of mandatory clearing, the Commission should draw that scope precisely. To that end, key terms such as "category," "group," "class" or "type" of swap need further definition.

It should also be noted that the cost for DCOs and swap counterparties is increased where higher levels of uncertainty in relation to the applicability and risk of a clearing obligation exist. This would suggest an early and narrow definition of the mandatory clearing requirement and a reasonable transition period to allow market participants to comply with the new clearing requirements is appropriate. A further transition period between the implementation of the mandatory clearing requirement and the application of any swap execution facility/trading requirements is also suggested.

The Five Factors of the Dodd-Frank Act

We welcome the Commission's acknowledgement in its proposed rule that the following five factors outlined in Section 723 of the Dodd-Frank Act[4] should be the basis for the Commission's determination:

(I) The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data.

Some types of swaps (for example CDS contracts in standard tenors and coupons referencing the on-the-run major traded indices) have a ready market of buyers and sellers, as evidenced

[4] See Section 2(h)(2)(D)(ii) of the Commodity Exchange Act, 7 U.S.C 2(h)(2)(D)(ii).

by bids and offers that change throughout a trading day. By contrast, more complex products are frequently tailored to a counterparty's risk management needs and thus may be less liquid. A good example here would be a CDS on a bespoke portfolio of credits: it may be difficult to obtain daily market prices for this product. Further, the tailored nature of products like these means that reliable pricing data may not be available, and this can lead to significant model and parameter risks in a models-based valuation.

It is critical that a DCO has the capacity and expertise needed to manage all of the risks associated with the products that it clears. These risks include potential valuation error, which can in turn lead to errors in estimates of initial or variation margin requirements and/or guaranty fund obligations. Since margin must be calculated at least daily, and since daily (or more frequent) market prices form the best basis for valuation, the availability of daily market prices for cleared products must be assured in all market conditions, including stressed markets. This is key since, if the amount held as margin turns out to be inadequate to cover the liquidation of a portfolio, then the DCO itself may be endangered.

Liquidity is also an important consideration in applying the mandatory clearing requirement because of the statutory linkage between mandatory clearing and mandatory trade execution on designated contract markets and swap execution facilities. Clearly the levels of liquidity necessary to impose such a mandatory trade execution requirement are, of necessity, greater than the levels necessary for clearing.

Based on the foregoing, it is clear that the size of the relevant swap market and its depth are crucial properties in the determination of the scope of mandatory clearing, and a conservative interpretation is required here. ISDA would be happy to provide expertise to the Commission to assist in the definition of appropriate measures of the liquidity required for clearing, for mandatory clearing, and for contract market/SEF execution.

(II) *The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded.*

This addresses two important and related points. First, it reinforces the importance of the consideration that the Commission must make under the core principles in assessing the financial integrity and operational competence of a DCO. In this context, the Commission's determination must also take into account, in assessing the enumerated factors, whether these factors can be satisfied by the DCO given the potential volumes which it would clear under a mandatory clearing requirement.

Second, the evaluation should be premised on the determination that the terms and conditions of the cleared swaps and the terms and conditions on which they are cleared are consistent with the material terms and trading conventions on which the relevant swaps are then traded.

These determinations are essential to ensure that the imposition of a mandatory clearing obligation for swaps will, in practice, actually achieve the statutory objectives of increasing market liquidity and reducing risk in the financial system rather than increasing it.

(III) *The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the DCO available to clear the contract.*

Like the preceding factors, this factor is intended to examine whether a mandatory clearing requirement with respect to the relevant swap would decrease systemic risk. This, in turn, requires an assessment of the size of the market for the relevant swap, the risk attributes of the swap, the scope and risk profile of other products cleared by the DCO, and the aggregate amount (and terms of availability) of the DCO's financial and credit support resources. Other risks, such as settlement and operational risks that can contribute to a clearing failure must, of course, also be considered.

Finally, the current and likely future importance of a DCO to the market it serves must be considered together with the extent to which the failure of a DCO will itself contribute meaningfully to systemic risk.

(IV) *The effect on competition, including appropriate fees and charges applied to clearing.*

This issue is important as while competition is essential, it also exposes DCOs to new risks. Thus, an assessment of a clearing application should address the potential conflict of interests between owners and management of DCOs and the wider financial system with particular sensitivity to risk management standards.

Here regulation has an important role in correcting the effect whereby low margin and guaranty fund levels may win a DCO business in the short term at the expense of wider financial stability. Lower margin and guaranty fund requirements should only be allowed where the Commission is confident that a DCO possesses sufficient alternative resources to support itself to a robust standard and where such a reduction does not materially increase systemic risk.

Finally, prudence would suggest that the Commission take into account competitive implications of the timing of imposing a mandatory clearing requirement in the light of the manner in which the distribution of open interest significantly constrains effective competition between DCOs.

(V) *The existence of reasonable legal certainty in the event of the insolvency of the relevant derivatives clearing organization or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property.*

Financial stability requires legal certainty of outcome in insolvency. This is essential to ensuring, that, upon insolvency, the assumptions on which credit support levels and default management procedures were structured are well founded and reliable. It is also essential in order to mitigate concerns that may deter participation in the market or in available clearing solutions. In particular, confidence in the portability of customer accounts upon the insolvency of a clearing member is extremely important to market participants.

As a related point, it is imperative that a comprehensive structure to address possible clearing market stress which might, if not mitigated, lead to clearing member or DCO insolvency is promulgated by the Commission in consultation with other stake holders. There are a number of requirements here:

(i) a general supervisory framework for DCO resolution. This framework, in conjunction with the rules of the relevant DCOs, is a critical requirement as market clarity is required on their resolution/bankruptcy regime;

(ii) for each DCO, a specific plan to address possible future stress. Such a plan might include consideration of whether an alternative DCO is able to clear a particular product prior to a determination of a mandatory clearing obligation for that product. This is important given that a DCO may be the principal venue for clearing a product and, in the absence of adequate continuity planning, DCO stress might preclude the functioning of the market for that product;

(iii) as a related comment, we would request greater clarity from the Commission on the application of Part 190 of the CFTC regulations[5], which along with subchapter IV of chapter 7 of the U.S. Bankruptcy Code, establishes a framework for the orderly and timely liquidation of an insolvent Clearing Member ("**CM**");

(iv) finally, it is important to note that both CM insolvency and DCO stress resolution have potential cross border aspects so clarity is also required on these matters.

The five criteria of the Act, if taken together and conservatively applied, make it highly likely that a DCO will be able to value, call for margin on, and risk manage all cleared products. Therefore, we encourage the Commission to interpret these criteria strictly, and only to mandate clearing for a particular product where they are clearly met at the time of the relevant application, and are highly likely to continue to be met in the future, including during future stressed periods. Such an approach will ensure adequate clarity and decrease the risk of inconsistent impositions of the clearing obligation. The Dodd-Frank Act provides the Commission with ample discretion and thus allows it to carry out its responsibilities in an efficient and prudent manner without the need to interpret these criteria loosely.

Given the importance of these criteria, we would welcome clarification from the Commission that these criteria will form the basis of both Commission-initiated reviews and of those undertaken as a result of a DCO submission or deemed submission.

We now go on to note some further issues relating to the Commission's review.

[5] The Commission is given the authority to prescribe these rules under Section 724 of the Dodd-Frank Act.

Mandatory clearing exemptions and stays

ISDA believes certain transactions, otherwise eligible for clearing, should not be subject to mandatory clearing. We encourage the Commission to document the scope of these exceptions so that firms have clarity on when they apply.

Counterparty risk reducing trades: The most obvious and prevalent concern involves trades where the derivative eligible for clearing would reduce counterparty risk if executed on a bilateral basis. Such trades often involve cases where the clearable trades ("**A Trades**") are hedges to unclearable trades ("**B Trades**"), and both trades are with the same counterparty. More specifically, we consider there to be two types of possible exceptions for A Trades:

(i) where the B Trades are likely to be clearable in the future
(ii) where the B Trades are unlikely to be clearable in the future.

The first type of exception would be necessary until the B Trades become clearable. For the second type of exception central clearing is never appropriate so the exception would last to the maturity of the trade.

More generally if clearing a clearable trade results in a material increase in counterparty risk, then this trade should be eligible for an exemption to mandatory clearing. This will often happen when a clearable trade hedges or partially offsets a particular non-clearable trade as discussed above, but there may be other instances of this phenomenon.

For instance, swap dealers manage their counterparty risk to each other, and to other counterparties, in part using active portfolio management techniques. Thus, if one or more unclearable trades exist between two parties, it may be decided to enter into a transaction which would reduce counterparty risk. This portfolio-risk-reducing trade may be clearable. However, requiring it to be cleared would evidently be counterproductive as it only reduces risk if executed on a bilateral basis. Therefore, mandatory clearing of such trades would deprive dealers of a valuable risk mitigation tool and would be contrary to the fundamental risk-reducing purpose of the Dodd-Frank Act.

Affiliate (intra-group) transactions: Another situation where an exemption for eligible trades to mandatory clearing may be appropriate concerns intra-group transactions. Transactions between affiliates allow entities within a corporate group to manage their overall risk more efficiently. Here central clearing would simply introduce further intra-group transactions (since it is likely that neither of the counterparties is the group CM) and thus forcing mandatory clearing in this situation would likely have no benefit in risk reduction, nor in decreasing the number of intra-groups trades. Moreover the associated initial margin requirements would result in an unnecessary consumption of group liquidity. Thus, we recommend an exemption from mandatory clearing requirements for all intra-group transactions.

Stay of clearing requirement: Section 723 of the Dodd-Frank Act provides the Commission the authority to stay the mandatory clearing requirement. We consider this to be an important provision as there are many circumstances under which the Commission should exercise this authority, some of which are discussed above. Further examples involve circumstances in which there is an absence of competition, or where there is an unresolved clearing member default at the only DCO then clearing the relevant product. Yet another, but important, example exists in circumstances where the Commission determines to impose a mandatory clearing requirement in a situation where a DCO has not elected to clear the product. As noted above, there are systemic risk implications where DCOs are allowed to clear products which they have not positively chosen to clear.

Finally, if a product subject to mandatory clearing becomes so illiquid as to threaten the DCO's ability to calculate margin or to manage a default, then a stay of the clearing requirement for that product may be necessary.

Additional Considerations

Standardization: For the avoidance of doubt, ISDA agrees with G-20 Leaders' position expressed in Pittsburgh in September 2009 that many types of standardized products should be eligible for clearing. ISDA considers that there are three elements to be considered in relation to standardization:

(i) *Legal uniformity*: this includes standard transaction documentation and definitions. A product's documentation will be sufficiently standardized if legal definitions exist, if participants have only a discrete number of documentation options to choose from, the swap is documented using market standard documents and definitions, if there is legal certainty of contract, and if the effects of default (and other life events) are well established and apply uniformly across the market.

(ii) *Process uniformity* (automation): this includes straight-through-processing facilitating the matching of confirmations, settlement and event handling. Electronic confirmation is the surest means of ensuring a contract exists and that a party is not subject to legal uncertainty because of delays in confirmation or lack of standardization in contractual terms.

(iii) *Product uniformity*: including standard valuation, payment structures, dates and determination of life cycle events. Conventions should be in place to govern how the product is traded, and existing industry practice should always be strongly preferred to novel arrangements. There should be a simple procedure for trading the product based on a "normal" transaction type. Industry practice here refers to events that might occur while the product is outstanding: rate resets, defaults, corporate actions, etc. All of these events should create effects that are well-known to and understood by market participants. In every case, product standardization should be driven by market needs, practices and priorities.

Wrong way risk: The Commission's determination in relation to the Swap Review and the DCO Eligibility Review must be sensitive to "wrong way risk", namely the risk that different risk factors be correlated in the most harmful direction.

Further and more specifically, clearing CDS whose reference name is either a CM or is highly correlated to the performance of a CM (for example, that of the sovereign in which the CM is incorporated) introduces a potentially systemic form of wrong way risk. We would urge the Commission to require DCOs to develop the appropriate risk management framework before any such systemically wrong way positions are mandated to be cleared.

Implementation timing: ISDA considers that two transitions periods, one from when a determination is made that a swap is subject to a "mandatory clearing requirement" to when such "mandatory clearing requirement" takes effect, the other from when a determination is made that a swap is subject to an "exchange or swap execution facility trading" requirement to when such requirement takes effect, are necessary to sensibly reflect the work required and risks involved in moving a product to central clearing and to trading venues. From a practical perspective, market participants will need sufficient time to conduct due diligence on any new DCOs/trading venues and put in place the necessary operational systems, processes and legal documentation in order to connect to such DCOs/trading venues. Accordingly, we recommend that the Commission consider an extended period between a determination being made that a swap is required to be cleared and clearing becoming mandatory on that product. This period would provide market participants the opportunity to make themselves appropriately ready to clear mandated transactions without risking either (i) disruption to their use of derivatives for hedging or (ii) noncompliance with the law. Similarly, we recommend a second transition period from when the "exchange/swap execution facility trading" requirement is determined to when such requirement takes effect in order to ensure that a stable and competitive market has time to develop. Further, ISDA would recommend full transparency of DCO requirements and performance during any such period(s). This will provide important notice and information for affected parties on what the relevant margin and guaranty fund calculations will be, what pricing requirements will be set by the DCO, how default management will operate, and to connect the relevant platforms and systems.

In addition and more specifically, the NPR states that the public review period will be 30 days and the total review time is 90 days. First, we suggest that the Commission extend the public review period to 45 days. Second, this public review period should only commence after:

(i) the DCO has proven the ability to clear the product through testing;

(ii) the DCO has sufficient operational resources and established connectivity to the market using standard protocols;

(iii) all market standardization issues defining the product, life events, etc. have been resolved;
(iv) pricing standards and margin calculations have been agreed by the DCO's risk committee; and
(v) the Commission has all the information it needs and (in respect of a DCO submission) this information has been verified as consistent with data from swap data repositories, swap dealers and major swap participants.

This process would address the risk that much of the information in the submission on which the Commission bases its determination of whether a swap is required to be cleared is provided by the DCO and the DCO has an economic interest in the particular swap being subject to mandatory clearing.

Rule 39.5(b) clarification: We wish to confirm that the Commission intends that a DCO Eligibility Review is to be separate from and precede a Swap Review and it is not intended that both reviews can commence simultaneously. As noted, the time for reviews is short and thus a specific focus and timeframe for each review is sensible.

Rule 39.5(c) clarification: We seek clarification that the authority granted to the Commission under Rule 39.5(c)(3)(iii), "Commission-Initiated Reviews", is restricted to requiring the retention of adequate margin or capital only for swap transactions that are not otherwise exempt from the clearing requirements.

Moral hazard concerns: In a circumstance where no DCO offers clearing services for a particular product, there are practical difficulties resulting from a Commission decision that mandatory clearing applies. Indeed, a determination of mandatory clearing in such a circumstance raises moral hazard concerns, as it may have the effect of requiring market participants to use a DCO despite their risk appetite.

2. Review of initial eligibility or the continuing qualification of DCOs to clear swaps

As clearing of certain swaps becomes compulsory under law, the DCOs that clear those swaps must be subject to rigorous organizational, conduct of business and prudential requirements. These requirements should reflect the new risks associated with clearing a swap and, if applicable, differing DCO membership. In addition, a DCO should have adequate internal systems, operational and administrative procedures, and should be subject to independent audits and disclosure requirements, including for example margin calculations. ISDA has separately commented on these and related issues, and we refer the Commission to our letters on governance and conflicts of interest for DCOs and on DCO financial resources[6].

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[6] These two ISDA comment letters can be found respectively at http://isda.org/speeches/pdf/CFTC-NPR-Comment-Letter-111610.pdf and http://www.isda.org//speeches/pdf/CFTC-Comment-CCP-Financial-Resources.pdf

As noted above, the Commission's review of DCOs should be proportional to the range of products the relevant DCOs clear, including the volume and risk characteristics of the products cleared. This also has implications for the determination of which DCOs are of systemic importance. That is to say, by virtue of its central role, a large DCO is likely to be a critical component of the market it serves. Consequently, the failure of such a DCO would probably result in a systemic event for the financial system.

As a related matter, the Commission's review of DCO eligibility should also take into account possible future market dominance and thus not 'crystalize' market standards or infrastructure which in the future may prove imprudent.

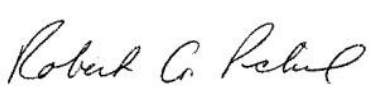
The Commission has proposed in Rule 39.5 that DCOs benefit from a presumption of eligibility to clear a swap that falls within a group, type, class, or category of swaps that the DCO is already authorized to clear. To some extent the issues raised by this proposal depend heavily on how broadly the Commission ultimately construes the terms such as "group" or "category". Even under a limited construction, however, this presumption may prove inappropriate. The best example of this would be a presumption that because a DCO clears liquid single name CDS (i.e. standard coupons and liquid tenors on names with good price visibility), then its risk metrics, pricing and historical data are adequate to support the clearing of a CDS of much longer tenors, or on different much less liquid underlyings. Such a presumption may lead to swaps being cleared that the DCO is unable to risk manage properly, the consequences of which would be to decrease the stability and soundness of such DCO.

Conclusion

The public policy rationale for the Dodd-Frank Act is to reduce risk, increase transparency and promote financial market stability by, inter alia, imposing a clearing requirement on swaps when the Commission determines that such requirement would be consistent with the five factors specified in the Dodd-Frank Act. ISDA believes that public policy is best served by the Commission interpreting these criteria strictly given the risks and alternatives tools available.

ISDA appreciates the opportunity to provide these comments. Should you require further information, please do not hesitate to contact the undersigned.

Sincerely,



Robert Pickel
Executive Vice Chairman

ISDA

APPENDIX 2

ISDA's submission to the CFTC – Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade dated February 13, 2012

February 13, 2012

Mr. David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW.
Washington, DC 20581

Re: CFTC RIN 3038-AD18 – Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade

Dear Mr. Stawick,

The International Swaps and Derivatives Association ("ISDA"), the Securities Industry and Financial Markets Association ("SIFMA") and the Futures Industry Association ("FIA")[1] appreciate this opportunity to provide comments to the Commodity Futures Trading Commission (the "Commission") regarding the recently released notice of proposed rulemaking and request for comments ("NPR") concerning the process by which swaps will be made "available to trade" and the implementation of the related statutory provisions enacted by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which amends the Commodity Exchange Act (the "CEA").

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[1] ISDA's mission is to foster safe and efficient derivatives markets to facilitate effective risk management for all users of derivative products. ISDA has more than 800 members from 58 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers. For more information, please visit: www.isda.org.

SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

The FIA is the primary industry association for centrally cleared futures and swaps. Its membership includes the world's largest derivatives clearing firms as well as exchanges and clearinghouses from more than 20 countries. The FIA seeks to promote best practices and standardization in the cleared derivatives markets, provide policymakers with an informed perspective on the derivatives markets, and advocate for the interests of its members, its markets and its customers. The FIA strives to protect open and competitive markets, protect the public interest through adherence to high standards of professional conduct and financial integrity, and promote public trust and confidence in the cleared markets. For more information visit" www.fia.org.

The designation of a swap as “available to trade” will have broad ramifications for the market because such a swap will no longer be permitted to trade on a bilateral basis. As a result, an incorrect designation of “available to trade” would result in a decrease in liquidity, increase in costs and a decrease in the availability of hedges. The goals of the Commission and the Dodd-Frank Act would therefore be best served if the determination of what swaps are "available to trade" are made by the Commission, based on careful and studied analysis that includes a finding of sufficient market liquidity. We note that the rules related to swap execution facilities (“SEFs”) have not yet been finalized and our comments might be affected by the final SEF rules.

Executive Summary

The following comment letter focuses on five topic areas: Process, Factors to Consider, Reviews, Economically Equivalent Swaps and Effective Date. Below is a brief summary of some of our key points.

1. Process - The Commission should make the determinations of which swaps are "available to trade". If swap execution facilities or designated contract markets (“DCMs”) make the initial determination, the process should include a six month period for Commission review before a submitted swap is made "available to trade" that will include an opportunity for public comment. A SEF/DCM should be required to list and support trading in a swap before the SEF/DCM may submit the swap as "available to trade".

2. Factors to Consider – Liquidity should be a prerequisite for a swap to be made "available to trade". The submitting SEF/DCM should provide detailed reasoning for its determination and specific supporting evidence of any valid factors considered.

3. Reviews – Swaps that are "available to trade" should be reviewed more frequently than annually and SEF/DCM participants/members should be able to submit swaps for review as no longer "available to trade".

4. Economically Equivalent Swaps – We ask that the Commission clarify the purpose of this rule as efforts to evade mandatory trade execution can be dealt with under existing anti-evasion authority. In the alternative, the definition of an "economically equivalent swap" should be based on fungibility, rather than "material pricing terms".

5. Effective Date – If the Commission does not establish a six (6) month review period, we recommend that the trade execution requirement take effect as of six (6) months after the later of (1) the applicable deadline for the clearing requirement, or (2) the date on which the swap is made "available to trade".

I. Process for Determination of "Available to Trade"

A. The Commission, not SEFs or DCMs, should determine which swaps are "available to trade".

The Commission is better positioned than SEFs/DCMs to make the determinations as to which swaps are "available to trade". The Commission has an overall view of the market and an ability to assess how the "available to trade" determination will affect market participants and financial markets generally. In contrast, SEFs and DCMs have an economic incentive to designate as many swaps as "available to trade" as possible, and to do so as soon as possible in order to acquire market share in trading those swaps. Accordingly, there is an inherent conflict of interest between the profit incentive of SEFs/DCMs to have as many swaps as possible required to be traded on their platforms and whether there is actual benefit to the market of requiring a swap to be traded on a SEF/DCM.

Our concern about allowing SEFs/DCMs to make the initial determination is exacerbated because of the proposed procedure for the "made available to trade" determination. In particular, if a SEF/DCM uses the certification procedure, the Commission will only have ten (10) days to review the determination, and potentially will have difficulty in rejecting a determination in the absence of a manifest error (especially when the rule is first implemented and multiple swaps are being submitted to the Commission.) This proposal therefore carries an implicit risk that SEFs/DCMs will be able to create monopolies in certain swaps by being the first to the market, shifting liquidity to it and thereby gaining market power in a particular swap. This result is contrary to the Dodd-Frank Act objectives of increasing competition and transparency in the derivatives markets. As stated by Commissioner Sommers, Congress did not intend "to allow a single DCM or SEF to make determinations that will have profound market-wide implications."[2]

There have been a number of instances in which exchanges have listed and maintained listings of products for which there is limited trading volume on the exchange. For example, there is very little or no trading volume in exchange listed calendar spread options in the interest rate market. By comparison, the OTC market for a comparable product, curve options, has significantly more trade volume. Although the volume for curve options is greater than that for the comparable calendar spread options, it is still probably not enough to justify imposing the trading requirement on market participants that occasionally need to hedge that type of unique risk on the basis of the trade volume in the curve option itself or as an "economically equivalent swap" to the exchange listed calendar spread option. However, under the proposed rule, a SEF/DCM would be able to designate the calendar spread option as "available to trade" and the curve option could be subject to the trade requirement as an "economically equivalent swap".

[2] Commissioner Sommers views the proposal as effectively "delegate[ing] implementation of the trade execution requirement of Section 2(h)(8) of the Act to DCMs and SEFs" and "an abdication of our responsibility as market regulators to provide clear rules of the road." CFTC Commissioner Jill E. Sommers, Opening Statement before the Sixth Open Meeting to Consider Final Rules Pursuant to the Dodd-Frank Act, December 5, 2011 ("Commissioner Sommers' Statement Dec. 5, 2011"); available at http://www.cftc.gov/PressRoom/SpeechesTestimony/sommersstatement120511

We are very supportive of having SEF/DCMs list products for trading in order to allow liquid and transparent markets to develop. However, allowing SEFs and DCMs to make determinations about whether a swap should be subject to a mandatory trading obligation on a SEF/DCM could add unnecessary frictions that prevent a justifiable risk hedge from being executed if a market participant needs to concern itself with (i) compliance reviews as to whether or not it can execute that risk bilaterally and (ii) the establishment of costly operational infrastructure necessary to connect to a SEF/DCM.

We note that a broad cross-section of market participants (including firms that run derivative trading platforms, the Federal Home Loan Banks, an insurance company and dealer firms) have urged the Commission to make these determinations, as evidenced by numerous comment letters in response to the earlier NPR regarding core principles for SEFs.[3]

In the commentary to the release, the Commission noted "that as it gains experience with its oversight of swaps markets, it may decide, in its discretion, to determine that a swap is available to trade."[4] However, because the trade execution requirement is new, no other parties should be deemed to be better suited or have more experience to make such determinations. In fact, it is particularly important that the Commission makes decisions when the rules are new and potential benefits and dangers are not fully known. The Commission has the broader market responsibility to assess the cost-benefit trade-off of whether the potential benefit of execution on a SEF/DCM outweighs the potential cost and liquidity impact of mandatory execution. For example, bespoke swaps with complex terms are a very important, though illiquid, component of risk hedging activity. It would not benefit, and indeed may harm, the markets and participants to designate such swaps as "available to trade", potentially making the market for such swaps even more illiquid or hindering market participants from trading in those swaps.

Finally, we note that the proposal differs from the approach taken by the European regulators. The European Commission has proposed that the determination of which derivatives will be required to trade on multilateral trading facilities ("MTFs") and organized trading facilities ("OTFs") will be made by the European Securities and Markets Authority ("ESMA").[5]

B. If SEFs/DCMs are given the authority to make the initial determination that swaps are "available to trade", then the process should require approval by the Commission after a six (6) month review period, that will include an opportunity for public comment.

The proposed process provides insufficient time for the Commission to perform a thorough review of submissions. Under the proposed rule, a SEF/DCM has the option to submit a determination under §§40.5 or 40.6 of the Commission's regulations.[6] It is likely that

[3] CFTC proposed rule, "Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade" ("Proposed Rule"), 76 FR 77728 at 77730 and fn 21.
[4] Proposed rule at 77731.
[5] See European Commission, Proposal for a Regulation of the European Parliament and of the Council on Markets in Financial Instruments and Amending Regulation [EMIR] on OTC Derivatives, Central Counterparties and Trade Repositories, Oct. 20, 2011, ("MiFID II") Article 26, p. 45; available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0652:FIN:EN:PDF
[6] Proposed Rule at 77730 - 1.

SEFs/DCMs will choose to make submissions under §40.6 given the lesser self-certification requirements. Under §40.6, the effective review period for self-certification will be only ten (10) business days (as opposed to the approval procedure which would be 45 days). Even if a SEF/DCM opts for the approval procedure under §40.5, proper review by the Commission and potential public comment within even a 45 day period will be very difficult, especially when the rules are first being implemented.

We urge the Commission to change the review process so that self-certification is not permitted, and to require a submitting SEF/DCM to make an application that must be approved by the Commission. We recommend a minimum six (6) month review period that would include a 30-day public comment period for any DCM/SEF application for an "available to trade" determination. While Dodd-Frank requires the Commission to undergo a rigorous review process for clearing determinations[7], the statute does not prohibit the Commission from stipulating a similar, or more stringent, process for mandatory trading determinations or require that DCMs and SEFs make the determinations through a less robust process than that utilized for mandatory clearing determinations. We believe that a longer review period for a trading determination is more appropriate than the period prescribed by the Commission in its process for review of mandatory clearing because a clearing mandate coupled with a SEF/DCM trading requirement will have far greater impact on the liquidity of a market than the clearing mandate alone.

If the Commission is concerned that a six-month review would unduly delay the initial implementation of the trade execution requirement, then we suggest that the Commission, in cooperation with SEFs/DCMs and market participants, develop an initial list of swaps that could be agreed to be available to trade. On-the-run CDX index swaps, for example, are broadly considered to be very liquid and therefore could quickly be made "available to trade". This will begin applying the trade execution requirement and provide the Commission and the market with a sample set to observe the effectiveness of the proposed process. Thereafter, the Commission could use the suggested six (6) month approval process. If the Commission does initially designate a set of highly liquid swaps as "available to trade", we note that the proposed compliance period should be longer than 30 days so as to permit market participants to put in place the necessary operational requirements.[8]

As noted earlier, we are very supportive of allowing SEFs to list and facilitate trading in many different types of swaps as part of the process of developing liquid and transparent markets. The purpose of a six (6) month approval period (with opportunity for public comment) would be to allow the Commission to have a reasonable time period to observe whether the market for a swap that a SEF/DCM lists for trading demonstrates sufficient liquidity on the relevant SEF/DCM and conformance with the other relevant factors. A review period of six months is both necessary and appropriate in order to (i) gather sufficient data critical for the determination; (ii) allow liquidity to develop in less liquid products and products that are newer to the exchange or SEF markets; and (iii) provide time for market participants to establish operational, technological and

[7] CFTC Final rule, Process for Review of Swaps for Mandatory Clearing, 76 FR 44464; DFA §723(a) – Clearing Requirement.

[8] CFTC proposed rule, Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements Under Section 2(h) of the CEA, 76 FR 58186.

regulatory infrastructure necessary to comply with the trading requirement and offer additional trading facilities. We believe that any determination of "available to trade" should be dependent upon data and analysis that adequately supports a finding of sufficient liquidity. For swaps under review, the Commission can request that DCOs and SEFs/DCMs provide data on transactions in that swap. In addition, the trade reporting and swap data repository rules ensure that the Commission will receive trade data that is relevant and sufficient for the Commission to assess whether there is sufficient liquidity for swaps to be made "available to trade".[9] The members of ISDA, FIA and SIFMA are available to assist the Commission in analyzing that data for purposes of measuring the observed liquidity.

By comparison, the process adopted by the Commission for the review of swaps for mandatory clearing does not rely on §§40.5 and 40.6 and provides more time for Commission review than is proposed for the "available to trade" determination.[10] The Dodd-Frank Act does not prescribe procedures for the trade execution requirement, but we believe that the process should be closer to the review process for mandatory clearing than to the review process for new rules under §40.5 or §40.6.

One final point to note on process is that the Commission characterizes the "available to trade" determination as a "trading protocol" of a SEF/DCM. As a result, in the proposal this determination is subject to the procedures under §§40.5 and 40.6 that apply to the adoption of a new rule. [11] However, the "available to trade” determination is not a trading protocol nor a rule. It is a determination as to whether a particular swap is subject to the trade execution requirement. There is therefore no reason for §§40.5 or 40.6 to apply and the Commission should instead adopt the procedures described above.

C. A SEF/DCM should not be allowed to submit a swap as "available to trade" that it does not list or support for trading.

We do not see a benefit or purpose to allowing a SEF/DCM to submit a swap that it does not list for trading. A SEF/DCM that does not trade in a swap has no direct knowledge of the market for that swap and whether or not it is liquid. Also, the SEF/DCM should have a demonstrated ability to provide that liquidity in a SEF/DCM trading environment, as discussed below. If a SEF/DCM does not need to list a swap in order to make the relevant determination, it will have every incentive to determine as many swaps as possible are "available to trade" to encourage use of SEFs/DCMs. In addition, by having not previously listed a swap and demonstrated the ability and experience to handle all aspects of trading, including post execution flows such as reporting and acceptance for clearing, a SEF/DCM may create significant amounts of operational risk through the introduction of trade breaks, reporting problems, and other errors.

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[9] See CFTC proposed rule - Reporting Recordkeeping, and Daily Trading Records Requirements for Swap Dealers and Major Swap Participants 75 FR 76666; CFTC final rule - Swap Data Recordkeeping and Reporting Requirements 77 FR 2136; CFTC proposed rule - Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps 76 FR 22833; CFTC interim final rule - Reporting Pre-Enactment Swap Transactions 75 FR 63080; CFTC interim final rule - Reporting Certain Post-Enactment Swaps Transactions 75 FR 78892; See CFTC final rule - Swap Data Repositories: Registration Standards, Duties and Core Principles Regarding Rulemaking 76 FR 54538.

[10] CFTC Final rule, Process for Review of Swaps for Mandatory Clearing, 76 FR 44464.

[11] Proposed Rule at 77730, col. 3.

The Commission should require that a swap be listed by a SEF/DCM in order for it to be "available to trade". Over a six month review period, the Commission can then gather reliable empirical evidence from the submitting SEF/DCM to determine whether there is sufficient liquidity to make the swap "available to trade". If sufficient liquidity is not demonstrated by activity on the SEF/DCM over the review period, the Commission may also draw on other relevant market information available to the Commission to determine that a given swap is "available to trade".

II. Factors to Consider

A. The Commission should require that a swap can only be "available to trade" if the swap is traded with sufficient liquidity.

The final rule should ensure that designation of a swap as "available to trade" is predicated on the determination that there is a liquid market for that swap on a SEF/DCM. As a result, a swap should not be "available to trade" unless there is sufficient liquidity on the relevant SEF/DCM. At a minimum, any determination submitted to the Commission should clearly demonstrate that trading in the swap exceeds minimum thresholds for liquidity. Simply listing eight factors without setting minimum parameters for a standard, as the current release does, does not offer sufficient guidance. In the absence of such guidance, it will be difficult for a SEF/DCM to apply the relevant test and for the Commission to review the determination. We strongly agree with Commissioner Sommers' statement that the general "lack of any parameters on how these factors should be considered will make it very difficult, if not impossible, for the Commission to reverse a determination."[12]

As stated in ISDA's March 2011 letter, liquidity should be determined on a product-specific basis and at a minimum each executable swap should trade multiple times with multiple counterparties.[13] Some examples of standards for which the Commission should prescribe minimum thresholds include: trading frequency (number of trades per day), market participation (number of swap dealers and unaffiliated non-swap dealer entities) and volume (aggregate notional amount per day). There may be other additional standards depending on the relevant product and market. We request a meeting with the Commission to provide further details on standards for liquidity. We urge the Commission to perform an in-depth study of the markets on a swap-specific basis, in conjunction with market participants, to determine appropriate measures of liquidity on a product-specific basis.

B. The "available to trade" determination should not be based solely on (i) "any other factor that the SEF/DCM may consider relevant" or (ii) whether a SEF supports trading in the swap, and those factors should be eliminated from the final rule.

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[12] Commissioner Sommers' Statement Dec. 5, 2011.

[13] ISDA comment letter to RIN 3038-AD18 – Core Principles and Other Requirements for Swap Execution Facilities, dated March 8, 2011 ("ISDA SEF Letter"), p. 8.

Proposed factor eight would give SEFs/DCMs too much leeway and subjective control in the determinations. We believe that liquidity is a necessary condition for a swap to be "available to trade" and determinations based solely on a catchall factor would allow illiquid swaps to be made "available to trade". Rather, we believe that, demonstrable liquidity should be a mandatory factor and any other factors considered by a SEF/DCM in its certification or application should also be supported by concrete evidence. In addition, as discussed earlier, we believe that it should be a prerequisite, not a factor for consideration, that a SEF/DCM list and support trading in a swap before the SEF/DCM may submit the swap as "available to trade".

C. Economically equivalent swaps should not be included in the assessment of the "available to trade" factors for a particular swap.

The determination of whether a swap is "available to trade" should be made on the basis of the liquidity for that particular swap, exclusive of any "economically equivalent" swaps. Liquidity is only meaningful for a specific swap, not among economically equivalent swaps. Further, as discussed below, the definition of "economically equivalent" swaps as proposed is too vague to ensure that an assessment including such swaps would be appropriate.

D. The Commission should require that SEFs/DCMs provide detailed reasoning in support of all determinations.

As part of the submission, including submissions under either the approval procedure of §40.5 or the certification procedures of §40.6, the SEF/DCM should be required to provide detailed explanations demonstrating that all relevant requirements, including sufficient liquidity, are met.

III. Reviews

A. Reviews should be held more frequently than annually.

As this process and implementation will be new to all market participants, we strongly recommend that reviews of swaps that have been made "available to trade" be conducted on a more frequent periodicity. Particularly in the early stages of implementation, frequent reviews of the by-products of the process will provide an on-going assessment of the process as well.

The liquidity and other trading characteristics of swap products change dynamically with market conditions. To help ensure that designations of "available to trade" appropriately reflect market conditions, the Commission should provide for more frequent reviews. Annual reviews are too infrequent given the nature and pace of the swaps markets. The cost and risk of infrequent reviews and updates arises when a swap that is "available to trade" becomes illiquid yet remains subject to mandatory trade execution on a SEF/DCM. Depending on the requirements of the final SEF rulemaking and the trading methodologies employed on the relevant SEF, this may constrain, and in some cases may prevent, market participants from executing trades in the swap.

B. The final rule should provide that market participants may request the Commission to determine that a swap is no longer "available to trade".

Market participants are able to observe trends and changes in the swaps market as they occur. The Commission should draw on this resource in determining on an on-going basis whether swaps are "available to trade". The final rule should allow market participants to submit a determination to the Commission that a swap is no longer "available to trade". We note that the Commission's final rule on mandatory clearing allows a swap counterparty to request a stay of the clearing requirement after a determination is made that the swap must clear.[14]

IV. Economically Equivalent Swaps

A. The rule should not address "available to trade" status for SEFs/DCMs other than the submitting SEF/DCM. The Commission can employ its existing anti-evasion authority to prevent evasion of trade execution requirements.

We do not understand the purpose or the effect of the proposed rule that once a swap is made "available to trade", such swap and any "economically equivalent swap" must be made "available to trade" on all other SEFs/DCMs that list such swaps. If the purpose is to prevent circumvention of the trade execution requirement, we suggest that it would be more efficient for the Commission to handle the issue under its existing anti-evasion authority in lieu of establishing a new rule that is not clear. For example, §6(e) of the CEA imposes liability on a swap dealer that knowingly or recklessly evades the requirements of §2(h) of the CEA, which includes the trade execution requirement.[15] Further, the Commission will have information on trading activity and will be able to observe if market participants attempt to evade the trading requirement by trading "economically equivalent swaps". Significant trading in such swaps could evidence sufficient liquidity and the Commission may then make an evaluation as to whether such swaps are "available to trade".

B. The definition of "economically equivalent swap" should be premised on fungibility rather than "material pricing terms".

If, despite our comment above, the Commission uses the phrase "economically equivalent swap", we would recommend that the definition be revised for clarity and specificity. The proposed definition is too ambiguous to be useful. The definition relies on "consideration of each swap's material pricing terms", without providing elucidation on what those terms should include. Commissioner Sommers stated that she does not know what that means and expects that market participants would not either.[16] Because, as stated above, a determination of "available to trade" depends on liquidity, only swaps that are fungible with each other should be affected by a determination that any one swap is available to trade. As a result, "economically equivalent" in this context should mean fungible.

Further, the Commission should provide a process for review of "economically equivalent swaps" before they become subject to the mandatory trade requirement. Under the proposed rule when the relevant submitted swap is made "available to trade", any SEF/DCM listing an

[14] CFTC final rule, "Process for Review of Swaps for Mandatory Clearing", §39.5(d), 76 FR 44464 at 44474.
[15] 7 USC §9a.
[16] Commissioner Sommers' Statement Dec. 5, 2011.

"economically equivalent swap" must automatically make such swap "available to trade". The "economically equivalent swap" itself is not subject to any antecedent review before being made "available to trade" and, under the proposal, only subject to an annual review by the SEF/DCM. Combined with the ambiguous definition, this approach would risk inappropriately subjecting swaps that are actually not appropriate to trade on a SEF/DCM to the mandatory trading requirement, which in the absence of liquidity may make them unavailable to market participants, to the detriment of their risk management activities.

The Commission should determine "economically equivalent swaps" based on the relevant criteria. Such determinations should be subject to Commission review and public comment and market participants should be able to request a stay for review. By way of analogy, in the context of mandatory clearing, the Commission will define groups, categories, types or classes of swaps that are subject to mandatory clearing, rather than the clearinghouses.[17] For example, for CDS, some parameters which the Commission should prescribe as minimum requirements for "economically equivalent swaps" are as follows: same reference rate, same reference entities, same currency, same exact maturity, same contingent events (e.g. Credit Events), same settlement mechanism, same coupon and same clearinghouse. There may be other additional parameters depending on the relevant product and market. We request a meeting with the Commission to provide further details on parameters for "economically equivalent swaps".

C. "Available to trade" should not be determined on the basis of a group, category, type or class of swaps.

The Commission asks in the NPR whether a SEF/DCM should submit its request with respect to a group, category, type or class of swaps. We believe the determination of "available to trade" should be made on a swap-specific basis. Liquidity is critical to the proper determination of "available to trade" and is only meaningful with respect to a specific swap, not with respect to a group or type of swap. Even the same type of swap can have very different liquidity levels for swaps with different tenors. This fact was highlighted, in particular, by the Federal Reserve Bank of New York analysis of actual trade data shows sharply varying trading volumes for different tenors of CDS.[18] In addition, developing appropriate and applicable definitions of groups, categories, types and classes of swaps presents its own difficulties and thus would add to the difficulty of making a determination of what is "available to trade".

[17] Ibid. at 44468.
[18] Federal Reserve Bank of New York Staff Reports, An Analysis of CDS Transactions: Implications for Public reporting; Staff Report No. 517, September 2011. Available at http://www.newyorkfed.org/research/staff_reports/sr517.pdf

V. Effective Date

A. The trade execution requirement should take effect as of six (6) months after the later of (1) the applicable deadline for the clearing requirement, or (2) the date on which the swap is made "available to trade".

Unless the Commission institutes a six month review period before a swap is designated as "available to trade", the proposed time frame of 30 days for the effective date of the trade requirement is too short. It is critical that market participants have sufficient time and resources to meet compliance deadlines. We urge the Commission to increase the time between a determination and the effective date of the trade execution requirement. If the Commission does not provide the six month review period recommended above, we recommend that the trade execution requirement take effect as of six (6) months after the later of (1) the applicable deadline for the clearing requirement, or (2) the date on which the swap is made "available to trade". Although we have expressed our concerns with the proposed timelines in our prior comment letter[19] to the Commission's proposed rule regarding compliance and implementation schedules, this is consistent with the proposed time schedule for compliance with the clearing execution requirements, under which the three categories of entities must be in compliance within 90, 180 and 270 days after the Commission issues any clearing requirement.[20] The suggested time period would allow for a smoother transition to SEF/DCM trading in the period after a determination is made. During this period many participants will be working to meet the documentation and other operational requirements of the relevant SEF/DCM. These operational requirements would include not only links between SEFs/DCMs and other participants, but also the different stages of testing required for new operations. If the compliance period is too short and market participants are unable to meet compliance deadlines they will be effectively prohibited from trading, which may have severe consequences on the markets. This will particularly be an issue soon after the new SEF rules are adopted, when procedures and requirements have not been standardized. It will also be an issue for a new SEF/DCM which does not have established networks and processes.

VI. Other

A. We strongly support the idea that the Commission post notices of all swaps that are made "available to trade" on its website.

In the absence of a central source for information on which swaps are "available to trade", it may be difficult for market participants to determine which swaps are "available to trade" and subject to the trade execution requirement. Lack of a central source that lists all swaps that are "available to trade" on various SEFs/DCMs would make rule compliance virtually impossible, especially if the Commission does not adopt very specific guidance for determining whether a swap is "economically equivalent" to a swap that has been determined to be "available to trade".

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[19] See FIA, ISDA and SIFMA joint comment letter to RIN 3038-AD60; RIN 3038-AC96; RIN 3038-AC97 – CFTC Proposed Compliance and Implementation Schedules for Clearing, Trade Execution and Margin, dated November 2, 2011.

[20] CFTC proposed rule, Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements Under Section 2(h) of the CEA, 76 FR 58186.

We note that under MiFID II, the European Commission proposed that ESMA post on its website a register of derivatives subject to the trade execution requirement.[21]

B. If a DCO or a member of a DCO defaults, then the trade execution requirements should not apply to a subsequent auction of the swaps to remedy the default.

An auction following a DCO or member default will need to take place very quickly and in a manner that meets the needs of a highly stressed situation. It may be impossible to execute the relevant trades through a SEF/DCM because of the volume, speed and complexity of the overall transaction. Requiring use of the SEF/DCM may, therefore, significantly undermine the procedures dealing with default and thereby cause dangers to the overall swap market. We therefore request that such transactions be exempt from the trade execution requirement.

C. The Commission should consider issues arising from the continuous trading aspect of the swaps market.

The swaps market is a global market in which trading occurs around the clock. The Commission should consider the impact of making swaps "available to trade" and imposing mandatory trade execution on SEFs/DCMs that do not operate 24 hours a day.

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ISDA, FIA and SIFMA appreciate the opportunity to comment on the proposed rule regarding making a swap "available to trade." Please feel free to contact the undersigned or Association staff at your convenience.

Sincerely,

Robert Pickel
Chief Executive Officer
ISDA

John M. Damgard
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[21] MiFID II, Article 27, p. 46.