ISDA® Safe, Efficient Markets

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Manager, Financial Markets Unit
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Dear Sir/Madam,

Introduction

The International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] welcomes the opportunity to respond to the Consultation Paper on the "*Implementation of a framework for Australia's G20 over-the-counter derivatives commitments*" ("**Consultation Paper**") issued in April 2012.

ISDA is actively engaged with providing input on regulatory proposals in the United States ("**US**"), Canada, the European Union ("**EU**") and in Asia. Our response is derived from these efforts and from consultation with ISDA members operating in Australia and Asia. Accordingly, our response draws on this international experience and dialogue and is not focused on technical aspects of Australian 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 Treasury independently.

ISDA commends the Australian Government for their careful consideration of these issues which would facilitate Australia meeting its G20 commitments regarding central clearing and trade reporting of OTC derivative transactions in line with other G20 countries, particularly the US and EU. 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 Consultation Paper, we would like to make a few general observations.

[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, visit www.isda.org.

Legislative framework

We support the introduction of a legislative framework through amendments to the Corporations Act that would empower the Minister for Financial Services and Superannuation (the "**Minister**") to prescribe certain classes of derivatives as being subject to a mandatory obligation, with detailed rules as to "what, who and when" to be set out in derivatives transaction rules ("**DTRs**") issued by the Australian Securities and Investments Commission ("**ASIC**") (subject to the consent of the Minister) after conducting market assessments and public consultation. We agree that this is a sensible manner in which to implement Australia's G20 OTC derivatives commitments as it will allow the regulators to continue to gather the necessary information on the implementation and impact of the reforms in the US and EU markets (particularly in regard to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**") and the European Market Infrastructure Regulation ("**EMIR**"), to carry out surveys on the state of the markets in Australia and to continue to engage in international regulatory coordination and cooperative efforts prior to implementing reforms in Australia.

However, we submit that there are a number of clear exceptions (both in terms of transaction types and participants) that should be enshrined in the Corporations Act itself or in overarching regulation rather than at the level of the DTRs. These include the circumstances set out in our response to Question 9 below.

In addition, given the global nature of OTC derivatives and the relative size of Australia's OTC derivatives market, we urge you to consider the global nature of the markets when implementing reforms so that the reforms do not restrict the ability of Australian 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.

Market-led initiative

We welcome the conclusion that it is preferable to let the market drive the move towards reporting, clearing and trade execution as this will ensure optimal solutions and outcomes. We believe that coupled with the appropriate incentives and disincentives, a market-led initiative will enable Australia to meet its G20 OTC derivatives commitments within a timeframe that is in line with other G20 countries. With regard to incentives, we urge that a review of existing insolvency and tax laws be conducted to ensure that they do not pose any impediments.

Recognition of foreign trade repositories, CCPs and trading platforms

We welcome the proposal to recognize foreign trade repositories, central clearing counterparties ("**CCPs**") and trading platforms. However, we have reservations about the proposal to extend the Financial Market Infrastructure ("**FMI**") framework. While there may be some basis for this in relation to foreign CCPs, we do not see the same rationale applying in the case of foreign trade

repositories and trading platforms. If and to the extent that the FMI framework is to apply to foreign CCPs, there needs to be specific parameters and processes spelt out so that a foreign CCP is not caught by surprise and find itself unable to comply with the location requirements – in a worst case, the foreign CCP may decide to stop clearing the relevant transactions and if there is no other eligible CCP, market participants will find themselves unable to fulfil the clearing mandate.

As you know, a significant volume of AUD IRS is already cleared by LCH and other foreign CCPs in a well-regulated environment. As such, market participants would expect these foreign CCPs to meet the requirements for recognition to be set by Australian legislators. We cannot over-state the importance to market participants of being able to continue to clear their transactions through foreign CCPs. Any legislation that favors recognition and use of a domestic CCP (rather than market forces driving the choice) will be counterproductive. It will result in fragmentation of trading volumes between different CCPs, thereby reducing netting benefits and increasing margining costs. The domestic CCP will in all likelihood have to charge more for its services as its clearing volumes will be lower. Ultimately, all these increased costs will be passed on to end-users in Australia.

Validity of contracts

We believe that it is of great importance for legislation to provide that even if any of the applicable mandates is breached that this will not affect the legal, valid and binding nature of the transaction concerned. We accept that there must be penalties for failing to comply with the applicable mandate but this should not expose the party that is in breach to the risk of its counterparty alleging that the transaction is therefore illegal, void and/or unenforceable or give rise to any claim for compensation by its counterparty. We note that a provision to this effect has been included in EMIR.

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. Capitalized 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.

3. DISCUSSION OF THE LEGISLATIVE FRAMEWORK

Question 1: Do you have any comments on the general form of the legislative framework?

As set out above, we support the general form of the legislative framework but are of the view that certain exceptions should be enshrined in the Corporations Act or overarching regulations and not left to the DTRs.

Question 2: Do you have any comments on the definition of 'transaction'?

A "transaction" is defined to include the "making, modifying or termination of a contract for derivatives". While the definition of 'transaction" may be appropriate in the context of the reporting mandate, it is clearly not appropriate in relation to the clearing mandate and may not be appropriate in relation to the trading mandate. In relation to clearing, only the making of a contract should apply as a transaction can be submitted for clearing upon its making. A transaction that is terminated does not need to be cleared. Requiring an uncleared transaction that is modified to be cleared is tantamount to requiring back loading (on which point, please refer to our response to Question 10 below). Trade execution facilities may not be set up to support the modification and termination of contracts.

Further, while "derivatives" is already defined in Section 761D of the Corporations Act, we believe that it would be worthwhile to review the definition for the purposes of the new legislative framework given the transformation of the regime that will apply to derivatives. For example, the embedded derivatives in a physically-settled commodity transaction with embedded derivative features would appear to be caught. 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 clearing and reporting) should be limited to bilateral transactions that do not include physically-settled commodity transactions or instruments with embedded derivatives or securitized derivatives. In addition, we believe that intra-group transactions should not be treated as "derivatives" for the purpose of the mandates as they are simply mechanisms for internal risk transfers within a corporate group (please also refer to our response to Question 9 below).

Question 3: Do you have any comments on the definition of 'party'?

A "party" is defined to mean "any domestic or foreign person who is dealing in a derivative (including on its own behalf) and is a party to a derivative transaction". A foreign person entity "must perform an action within the Australian jurisdiction that contributes to that entity becoming a party to the transaction".

We submit that the proposed definition is overly broad and ambiguous. For example, would the offshore subsidiary or branch of an Australian-incorporated entity be caught as a "domestic person"? What action within Australia would be deemed as contributing to a foreign person becoming a party to the transaction? For example, an American bank through its Singapore branch enters into an AUD interest rate swap transaction with a Singapore customer, and a trader in its Sydney branch is involved in pricing the transaction, would the American bank be caught? For reasons elaborated on below, we submit that the answer should be "no" as the transaction is not booked in Australia. We request clarification of the intent behind including "dealing in a derivative (including on its own behalf)" in the definition, in particular, whether it will be defined by reference to the Corporations Act (i.e., sections 766C(1) and 761E as it relates to persons taken to be an "issuer" of a "derivative").

More importantly, given that there are different rationales for imposing a clearing, reporting and trade execution mandate, we believe that it would not be appropriate to apply a common definition of "party" for all three mandates. Instead, we believe that a better approach would be to determine who should be "caught" based on an analysis of how that achieves the purpose for imposing the relevant mandate.

The rationale for imposing a clearing mandate is to mitigate systemic risk by substituting the credit of the CCP for counterparty credit risk; it also reduces counterparty credit risk through multilateral netting of transactions and mutualisation of losses through a default fund. A transaction may pose risk to the Australian financial system where it is booked in Australia. We would add that we understand a transaction to be booked in Australia if a party to the transaction is an Australian-incorporated entity or Australian branch of a foreign-incorporated entity. Where the transaction is booked in say the Singapore branch of an Australian-incorporated entity, we would not consider that transaction to be booked in Australia. Thus, in relation to the clearing mandate, we believe that the focus should be on whether the transaction is booked in Australia. This approach also has the benefit of reducing the likelihood of conflicting clearing mandates being imposed by different regulators.

The rationale for imposing a reporting mandate is to improve transparency particularly to regulators, thus enhancing their ability to assess systemic risk and conduct resolution activities in a worst case scenario. We agree that in addition to transactions booked in Australia, an Australian regulator would be interested for example in transactions booked in overseas branches of an Australian-incorporated bank. Nevertheless, we submit that it would still be appropriate to impose a reporting mandate only for transactions booked in Australia and for the Australian regulators to co-ordinate with other global regulators to ensure that they have access to relevant data required to be reported elsewhere. We believe that this would be more efficient and would reduce the risk of double-counting of reported transactions.

With regard to trade execution, we think that it is premature to consider this for the reasons set out in our response to Question 20 below.

Question 4: Do you have any comments on the definition of 'eligible facility'?

Assuming that the definition caters for foreign trade repositories, CCPs and trading platforms, we do not see any issues.

Question 5: Do you agree that non-discriminatory access requirements should be imposed on eligible facilities?

While the concept of non-discriminatory access is laudable, much thought needs to be given to how this principle should be applied in relation to CCPs. CCPs need to be sufficiently capitalized to absorb default risks and they need to have access to trading expertise and resources to manage the replacement of defaulted positions. Membership requirements affect the ability of CCPs to muster the necessary resources.[2] For example, a CCP whose membership criteria includes a

[2] The Economics of Central Clearing: Theory and Practice, by Dr. Craig Pirrong, University of Houston dated May 23, 2011 http://www2.isda.org/functional-areas/research/discussion-papers

high minimum capital requirement, being subject to regulatory oversight (essentially limited to regulated financial institutions), and an assessment of the adequacy of the applicant's operational infrastructure, rating levels (including appropriate margin multipliers on downgrade), and ability to price and trade OTC derivatives would be a safer and stronger CCP. Conversely, less restrictive membership requirements (for example, a small minimum capital requirement for membership, no minimum standards as regards licensing, risk management, trading and operational infrastructure, no requirement for members to commit trading resources to manage replacements) tend to increase the heterogeneity of CCP membership and result in a weaker CCP. Thus, any legislative obligation to provide non-discriminatory access needs to carefully consider the prudential implications of membership requirements on the CCPs.

Question 6: Do you have any comments on the rule-making power that will be available to ASIC?

We do not see any issues with ASIC being given rule-making powers via the DTRs, subject as set out above, to certain exceptions being enshrined in the Corporations Act or overarching regulation. In addition, as proposed in the Consultation Paper, there should be requirements for ASIC to consult stakeholders and for sufficient periods of time to be provided for consultation and before any DTRs take effect. Such requirements should be provided for in the Corporations Act or in overarching regulation.

Question 7: What should be the minimum period of consultation imposed on ASIC in developing DTRs?

The period of consultation must allow for detailed consideration and discussion between ASIC, other regulators, market participants and trade repositories, CCPs and trading platforms (as the case may be). As such, the minimum period of consultation will be determined by a range of factors (including the complexity and scope of the reporting, clearing or trade execution requirement, the nature of the prescribed derivatives and whether an appropriately licensed trade repository, CCP or trading platform is already in existence). In light of this, we believe that the period of consultation needs to be determined on a case-by-case basis taking into account all relevant factors. It is therefore inappropriate to prescribe a minimum period suitable for all classes of derivatives transactions and for all the mandates. We recommend that the views of all stakeholders should be sought on the appropriate consultation period in each case.

By way of example, experience in the US and EU has shown that trade reporting requirements raise unique technical issues due to the varied nature of the underlying transactions and, in addition, pose significant operational challenges and costs, at least in the initial stage, given the infrastructure requirements.

Question 8: What should be the minimum period of notice between when a DTR is made and when any obligation under the DTR commences?

As with the consultation period, the minimum period of notice should be determined on a case-by-case basis taking into account all relevant factors (including the complexity and scope of the reporting, clearing or trade execution requirement, whether back-loading is required, whether an appropriately licensed trade repository, CCP or trading platform is already in existence, whether market participants are required to develop new infrastructure or significantly modify or enhance existing infrastructure, and the period of testing of new or modified infrastructure that may be required). It is therefore inappropriate to prescribe a minimum period suitable for all classes of derivatives transactions and for all the mandates. We recommend that the views of all stakeholders should be sought on the appropriate notice period in each case.

Question 9: Although the possible counterparty scope is set broadly, should minimum thresholds for some or all types of counterparty be set by regulation, so that no rule that is made will ever apply to those counterparties (unless the regulation is subsequently changed)?

As mentioned above, we submit that there are a number of clear exceptions (both in terms of transaction types and participants) that should be enshrined in the Corporations Act itself or in overarching regulation rather than at the level of the DTRs. We set out below some examples but would stress that these are not the only transaction types and participants that should be exempted and the legislative framework should provide an avenue for additional transaction types and participants to be exempted through overarching regulation and not in the DTRs:

(a) *Foreign exchange spots, forwards and swaps*: 68% of foreign exchange forwards and swaps are up to 7 days, with another 30.8% being more than 7 days and up to 1 month, thus leaving a mere balance of 1.2% that are more than one month[3]. Hence, these transactions pose settlement risk rather than counterparty credit risk and settlement risk is already dealt with through CLS Bank. Thus, these transactions should not be subject to a clearing or trade execution mandate. This is in line with the proposed reforms in the US and EU and Asian markets like Singapore and Hong Kong.

(b) *End users*: Affordable access to appropriate methods of hedging, including the use of OTC derivatives, is vital to end users as they seek to cover themselves against commercial risks directly linked to their commercial or treasury financing activities. If end users are subjected to a clearing or trade execution mandate, they may find it too difficult and/or too expensive to make use of OTC derivatives and opt not to hedge their commercial risks. Again, the proposed reforms in the US and EU and Asian markets like Singapore and Hong Kong recognize the importance of providing an end user clearing exemption (thus also not subjecting them to a trade execution mandate). To provide clarity and certainty, we submit that the definition of an end user should be provided for in the Corporations Act or overarching regulation and not at the level of the DTR. The definition should include the key indicia that needs to be satisfied, for example, (i) that it is sufficient that the transaction reduces risk relating to its treasury financing activities, and is not confined to reducing risk

[3] Bank for International Settlements' Triennial Central Bank Survey December 2010.

relating to its commercial activities, and (ii) the criteria to be used in setting the clearing threshold. However, we agree that the threshold level per class of OTC derivatives should be prescribed via the DTR.

(c) *Intra-group transactions*: We submit that intra-group transactions should not be subject to a clearing or trade execution mandate. Intra-group transactions are used for aggregating risks within a group structure so that they can be centrally risk managed more efficiently. Requiring intra-group transactions to be cleared may limit the efficiency of the intra-group risk-management process. Intra-group transactions simply represent an allocation of risk within a corporate group - they do not increase systemic risk or threaten the safety and soundness of entities under common control.

Further, we submit that it is not appropriate to impose margin requirements on intra-group transactions. 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. 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.

As the rationale for imposing a reporting mandate is to improve transparency, thus enhancing the ability of regulators to assess systemic risk and conduct resolution activities in a worst case scenario, we submit that it is not necessary to require reporting of intra-group transactions as they do not increase systemic risk. Insofar as regulated entities are concerned (for which resolution activities in a worst case scenario would be relevant), their regulators will already have access to data on the group's exposures.

(d) *Public bodies*: We submit that governments, central banks, supra-national and multilateral organizations and bodies engaged in the management of the public debt should not be subject to a reporting, clearing or trade execution mandate.

(e) *Superannuation funds*: Superannuation funds typically minimize their allocation to cash in order to maximize the efficiency and the return for their policy holders. CCPs currently accept cash collateral only. Thus, requiring superannuation funds to submit their transactions for clearing would require them to liquidate a significant portion of their assets so that they will be able to post cash collateral to meet the ongoing margin requirements of CCPs. This will likely have a negative impact on the return to policy holders. As such, we submit that superannuation funds and pension funds should be exempt from clearing until such time as initiatives to broaden the scope of eligible collateral accepted by CCPs or in regard to "collateral transformation" services bear fruit. It is worth noting that the EU has granted an initial 3-year exemption for pension funds.

Question 10: From the point of view of your business and/or of your clients, do you have concerns around any 'back loading' requirements? For example, are there any problems with obligations applying to transactions that are outstanding at the time the rule is made?

Our members strongly disagree with the back loading of outstanding transactions for clearing. There are major legal and practical challenges in connection with back loading. 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. Further, it is impossible for a single market participant to comply without agreement from its 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 bilaterally 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 (for example, 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. It is worth noting that there is no back loading requirement for clearing in the US and EU.

With regard to back loading of transactions for reporting, our members are concerned about the operational and cost burden this would have on market participants. The back loading 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 that a sufficient timeframe for compliance with such requirement be provided and that the back loading requirement be consistent with international standards.

4. OPTIONS FOR IMPLEMENTING MANDATORY OBLIGATIONS

Question 11: Do you agree with the option of prescribing a broad range of derivative classes to be subject to the mandate for trade reporting? If not, what other option do you prefer?

The range of derivative classes that are prescribed should be consistent with the approach taken in the US and EU.

Question 12: Do you agree with the option of including a broad range of entities in the mandate to report trades? If not what option do you prefer?

As set out in our response to Question 3 above, we submit that a reporting mandate should be imposed only for transactions booked in Australia and for the Australian regulators to co-ordinate with other global regulators to ensure that they have access to relevant data required to be reported elsewhere.

Question 13: Are there specific classes of entity that should be excluded from the potential reach of trade reporting DTRs?

Please refer to our response to Question 9 above.

Question 13.1: What metrics should be used to determine any thresholds?

Please refer to our responses to Questions 12 and 13 above on ‘who’ and ‘what’ should be subject to the reporting mandate.

Question 13.2: What should be the thresholds of these metrics that trigger when an entity may be subject to trade reporting rules? Should this threshold vary depending upon the nature of the entity?

Please refer to our response to Question 13.1 above.

Question 13.3: What is an appropriate threshold to exempt end users from the mandatory obligation to report OTC derivatives transactions to a trade repository or regulator?

Under the Dodd-Frank Act, reporting of all swaps is required and we have generally been supportive of this. However, we recognize that different considerations may apply to the Australian market which is relatively smaller and requiring reporting across-the-board may impose too onerous a burden on end users that are minor participants in the market. Nevertheless, we think that a more pragmatic solution would be to allow an end user to fulfil its reporting obligation by entering into an agreement with a third party (whether that be its counterparty, the CCP, the trading platform or third party service providers such as trade matching and confirmation platforms) to report on its behalf and not holding the end user responsible for the timeliness and accuracy of data reported by such third party. This represents the position under the Dodd-Frank Act where end users generally do not have any reporting responsibilities unless their counterparty is another end user.

Question 14: Do you agree with the option of including a broad range of transactions in the mandate to report trades? If not what option do you prefer?

The range of transactions to be reported should be consistent with the approach taken in the US and EU.

Question 14.1: Are there specific classes of transaction that should be excluded from the potential reach of trade reporting DTRs?

Please refer to our response to Question 9 above.

Question 15: Do you agree with the option of using a wide definition for what would constitute a transaction in this jurisdiction for the purposes of mandating trade reporting? If not, what definition do you prefer?

Please refer to our response to Question 2 above.

Question 16: Do you agree with the option of relying upon market forces and a range of other mechanisms, such as capital incentives, while monitoring the impact of such mechanisms in systemically important derivative classes and providing for possible future mandating, to ensure that central clearing becomes standard industry practice in Australia within a timeframe that is consistent with international implementation of the G20 commitments? If not, is there another option you prefer?

Yes.

Question 17: Are there specific entities that should be excluded from the potential reach of central clearing rules?

Please refer to our response to Question 9 above.

Question 17.1: What metrics should be used to determine any thresholds?

Please refer to our response to Question 17.2 below.

Question 17.2: What should be the thresholds of these metrics that trigger when an entity may be subject to trade clearing rules? Should this threshold vary depending upon the nature of the entity?

In principle, we believe that the clearing threshold should be based on the net uncollateralized mark-to-market exposure per class of OTC derivatives that an entity has. However, we recognize that any determination based on the mark-to-market value of outstanding positions may 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. While calculating the outstanding positions of an entity on the basis of its notional (average or otherwise) value of such positions would be much more straightforward, this may not in all cases reflect the true level of risk to which such entity is exposed.

In any case, the threshold level should be determined on a case-by-case basis taking into account all relevant factors (including the relative size of the Australian and global OTC markets represented by that class of OTC derivatives). It is therefore inappropriate to prescribe a threshold level that is applicable across all classes of derivatives transactions. In addition, details such as how frequently the threshold level should be tested will need to be determined. The responsibility for monitoring a counterparty's derivatives exposure and whether it is above the clearing threshold will also need to be laid out. A party would not be in a position to determine

whether its counterparty has exceeded the 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.

In addition, we are of the view that only transactions of the relevant class should be taken into account in determining whether the clearing threshold has been breached. This would ensure that an entity that exceeds the clearing threshold for a particular transaction class will only be required to clear those transactions and not transactions of a different class that does not separately meet its own clearing threshold. An entity that does not have significant exposure in a particular transaction class should not be required to bear the costs of submitting those transactions for clearing simply because it has a large exposure in a different class of transaction. Further, risk-reducing transactions and intra-group transactions should not be counted towards the threshold.

Question 17.3: What is an appropriate threshold to exempt end users from the mandatory obligation to clear OTC derivatives classes?

Please refer to our response to Question 17.2 above.

Question 18: Are there specific classes of transaction that should be excluded from the potential reach of trade clearing DTRs?

Please refer to our response to Question 9 above.

In addition, we would urge that you carefully consider whether the imposition of mandatory clearing in respect of any 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.

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.

This may also 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 Australia thereby reducing the ability of end users to use derivatives efficiently to risk manage their businesses and further damaging the liquidity of the Australian OTC derivatives markets. Given the recognised importance of the OTC derivatives market for the economic development of Australia, this may have an unintended and damaging effect on the continued growth and development of the Australian economy.

We urge you 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 Australian-booked share of the global market to ensure that mandating clearing of these products would in fact result in systemic risk reduction.

If mandatory clearing of any product is to be imposed, the timing of such imposition and the availability of eligible CCPs at such time is critical. We agree that mandatory clearing should not be imposed until and unless appropriate eligible CCPs are available to market participants, whether through direct access or client clearing. It is thus imperative that the criteria that foreign CCPs will need to satisfy be communicated in ample time ahead of the imposition of any mandate so that they (especially CCPs such as LCH that already clear a substantial volume of AUD IRS) can be timely recognized in Australia. If there is any risk that such recognition cannot be completed ahead of the imposition of a clearing mandate, we suggest that the regulators consider adopting a "grandfathering" approach whereby certain foreign CCPs, by virtue of their regulation by an acceptable home regulator, are provided a temporary license.

We would like to add that we support a carefully balanced combination of both the top-down and bottom-up approaches to identifying products suitable for mandatory clearing, pursuant to which regulators would be required to work closely with eligible CCPs and market participants (who are the ones most subject to the risks associated with inappropriate clearing) to determine the suitability of subjecting an OTC derivatives product to the mandatory clearing regime. It is also important that when considering whether to extend mandatory clearing to a class of derivatives, that due consideration be given to the systemic risks which may be created by clearing such derivatives on CCPs.

While regulators may consider that it is important to have the ability to directly control the scope of mandatory clearing, the top-down approach has the potential to increase systemic risk as a regulator may not be in the best position to determine the 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 that due regard be given 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.[4]

[4] Recommendation VIII: A determining authority should consider using a top-down approach and may utilize 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.

Under a bottom-up approach, regulators 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 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 that due regard be given to the relevant recommendations set out in the OICV-IOSCO Paper, in particular Recommendations IV, V and VI.[5]

We would also like to 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. In brief, in determining whether to impose a clearing mandate on a product, the following criteria should be considered:

(a) Level of systemic risk posed by the product.
(b) Product characteristics (including analysis of complexity, volatility, tail/gap risk and dependency/correlation risk in member cleared portfolios).
(c) Level of standardization of contractual terms and operational processes.
(d) Existing infrastructure framework (such as operational expertise and margining capabilities) in respect of the trading and settlement of the product.
(e) Depth and liquidity of the market for the product, bearing in mind that the market that will be captured by the proposed clearing regime (say with one party booking the transaction in Australia) may be markedly different from the global market for that product;
(f) Availability of fair, reliable and generally accepted pricing sources for the product.
(g) Availability of eligible CCPs and the robustness of their risk management systems for the product.
(h) Where only one CCP exists that can clear the product, competition and market issues. This is because allowing a de facto regulatory driven monopoly in clearing a product may distort market incentives.
(i) Degree of certainty as to the legal treatment in the event of insolvency of any CCP or its clearing members.

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[5] 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.

(j) Costs of submitting the product for clearing which will be passed on to market participants.
(k) 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.
(l) Anticipated positive effects on the OTC derivatives market if the product becomes subject to mandatory clearing.
(m) Projected harmful effects on CCPs if the product becomes subject to mandatory clearing.
(n) International regulatory approach towards the product.

As an example, we think that there is an insufficient degree of standardization in documentation for equity derivatives at least in the near term. ISDA has recently developed and published new documentation architecture for equity derivatives to facilitate standardization. Even with this, it remains to be seen how much of the product will become standardized. The reason for this is that equity derivatives contain many unique risk allocation provisions which need to be bilaterally negotiated between two counterparties (for example, there are many different events which can occur to the underlying reference asset during the duration of the trade (e.g. bankruptcy of the issuer, de-listing, merger or tender offer) under which the counterparties may elect to adjust the trade or terminate). The ability to negotiate and tailor such provisions allows flexibility as to pricing. If market participants are forced to standardize such provisions in order to enable central clearing, this may lead to higher prices and lower liquidity as dealers will have less flexibility to manage or hedge their risk. In addition, there has been little discussion in other important jurisdictions such as the US and the EU on clearing of equity derivatives and so far, none of the major clearing houses have announced any initiatives in relation to equity derivatives.

Finally, the product that is to be subject to mandatory clearing must be clearly specified. 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.

Question 18.1: In particular, should some transactions entered into for certain purposes (for example, hedging, commercial risk mitigation) be outside the potential reach of the rule-making power?

Please refer to our response to Question 9 above.

Question 19: Do you agree with the option of requiring central clearing for derivatives where at least one side of the contract is booked in Australia and either: (a) both parties to the contract are resident or have presence in Australia and are entities that are subject to the clearing mandate; or (b) one party to the contract is resident or has a presence in Australia and is subject to the clearing mandate, and the other party is an entity that would have been subject to the clearing mandate if it had been resident or had a presence in Australia? If not, what definition do you prefer?

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 clearing should apply. In particular, we welcome the proposal to exclude contracts between entities that are neither resident nor having a presence in Australia. 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 multi-branch entity and may be acting through its head office or branch in Australia; and

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

Members have requested for clarification that where a 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 Australia 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 a contract on behalf of an individual fund.

We request that an exemption be provided where contracting parties (who would otherwise be caught by the mandatory clearing requirements) are already subject to mandatory clearing requirements in acceptable overseas jurisdictions. At the least, such exemption should be provided if mandatory clearing is imposed prior to any foreign CCPs being designated as an 'eligible facility'. 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 trade repositories, it is not possible to submit a transaction for clearing through two separate CCPs.

Question 20: Do you consider that there are any OTC derivative classes for which an execution on trading platforms mandate would be appropriate at this time? If so, please provide any evidence which supports your view.

We believe that it is premature at this point to introduce a trade execution mandate. We believe that market participants should be allowed to decide whether or not to trade on an organized 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 incentivized 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.

As the G20 recognized, it is not always appropriate for derivatives trading to take place on organized trading platforms even if the transactions have become relatively standardized. 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.

If trade execution is mandated 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 arise:

(a) *The inability to customize*: Overly-ambitious promotion of a particular trading platform would likely concentrate trading activity in a subset of existing contracts, weakening the ability of market participants to customize contracts. More importantly, concentrating the market into a more narrow range of products linked to particular trading platforms 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 customized 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 organized trading platforms 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 standardized, 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 customized 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 organized trading platforms could therefore make risk transfer less efficient.

Question 21: Alternatively, do you agree with the option of applying the same approach to prescribing entities, transactions and derivative classes as has been applied for mandating clearing?

No, we would strongly caution against this. At a minimum, regulators should make an independent assessment as to whether a swap should be executed on an organized trading platform separate from its clearing determination with respect to the same swap. In this respect, we note that under the Dodd-Frank Act, a swap that is required to be cleared must be executed

on a swap execution facility ("**SEF**") or designated contract market ("**DCM**") unless no SEF or DCM makes that swap "available to trade". The determination of whether a swap should be designated as being "available to trade" on an SEF or DCM is an exercise unto itself. In this regard, we would like to refer you 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: If a derivative class is prescribed for mandated use of CCPs should it also be mandated for execution on a trading platform?

No, please refer to our response to Question 21 above.

Question 23: Do you agree with the option of initially excluding the same entities and transactions from the mandate to execute trades on trading platforms as those for the mandate to clear through a CCP? If not what option do you prefer?

No, please refer to our response to Question 21 above.

Question 24: Do you agree with the option of using the same definition of a transaction in Australia for the purposes of mandating executing a trade on a trading platform as for mandating clearing transactions through a CCP? If not, what definition do you prefer?

Please refer to our response to Question 2 above.

5. TRADE REPOSITORIES

Question 25: From the point of view of your business and/or that of your clients, do you have concerns with reporting Australian trades to Australian and/or international trade repositories?

Our 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. Our members also request that the reporting mandate be implemented in phases with implementation of the first phase being no earlier than that under the Dodd-Frank Act and EMIR. Where possible, our members encourage the development of rules that would allow for and promote the creation and use of global trade repositories in each relevant asset class, with the Australian regulators being given access to relevant data in the global trade repositories. We strongly encourage the adoption of international data reporting and aggregation standards recommended by CPSS-IOSCO and the adoption of a Legal Entity Identifier and a product classification system aligned with international standards.

One significant concern that our members have is the scope of applicable 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, our 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. 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. Any legislative change should be wide enough to cover any mandatory trade reporting to trade repositories (including through third party service providers) and regulators (not just the Australian regulators 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). Pending such legislative change, market participants are faced with the difficult prospect of having to manage conflicting regulatory requests and requirements and contractual obligations. As such, we would propose that pending legislative change, an exemption from the reporting obligation should apply when any applicable laws prohibit trade reporting. At minimum, market participants should be allowed to screen data that they have for each customer (or class of customer) and manually block its disclosure so that client names are shielded. 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 trade repositories on a no-names basis face the risk that doing so may breach contractual confidentiality obligations to their clients.

Question 25.1: What restrictions should there be on the disclosure of reported data by trade repositories? What requirements should be imposed in relation to data protection and privacy?

We are of the view that trade repositories should only be allowed to disclose relevant reported data to a regulator. Further, trade repositories should be allowed to make public disclosure if and to the extent that the regulators consider such public disclosure to be necessary.

Given that confidentiality is the cornerstone of the trade reporting system, a minimum condition before a regulator is given access to relevant data should be that such regulator should publicly commit itself to following high standards, as well as to publishing information on the relevant legal framework regarding their confidential use of information. The basis for determining the kind of data that is relevant to a particular regulator should be clear and universal in its application – we believe that the principles set out in the June 2010 paper by the OTC Derivatives Regulators Forum[6] provide a good starting point.

We believe that any public disclosure 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 disclosure of reported trades, every effort should be made by trade repositories to avoid impacting the reporting entity's ability to properly hedge itself for the reported trades in the market. Preferably, any public disclosure 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 disclosure proposed by any trade repositories 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

[6] Attached as Appendix 3.

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.

Question 25.2: What restrictions should there be on the use of reported data by trade repositories?

Except for the purposes set out in our response to Question 25.1 above, trade repositories should not be allowed to use reported data.

Question 25.3: What restrictions should there be on the sharing of trade repository data between TRLs; and on the sharing of trade repository data between regulators (both domestic and international)?

Data should be provided by a trade repository to another trade repository only where the reporting party has authorized the same.

With regard to the sharing of trade repository data between regulators, please refer to our response to Question 25.1 above.

Question 25.4: Should the prices and sizes of individual transactions reported to trade repositories be made publicly available? If so, do you have any views on the time frame in which the information should become publicly available? Should there be different time periods for public release of transaction data depending on the size of particular transactions?

Any public disclosure mandate should be in line with requirements under other reform initiatives such as the Dodd-Frank Act and EMIR. We would urge the regulators to consult further with market participants on the scope, nature and timing of public disclosure. Any public disclosure requirement should take into account the considerations raised in our response to Question 25.1 above.

Question 26: Would Australian market participants support a domestic trade repository as an alternative to an international trade repository, recognising there are likely to be cost implications in establishing and maintaining a domestic trade repository?

Market participants should be allowed to choose whether to report to a domestic or international trade repository (assuming that a domestic trade repository comes into existence). The major participants in the Australian market will be faced with multiple mandatory reporting requirements and for them, the most efficient and cost-effective means of compliance will be to report all their transactions globally to one global trade repository in each relevant asset class, with the relevant regulators being given access to relevant data in the global trade repositories.

Question 27: Is it appropriate for ASIC or another regulator to have the power to grant licenses to trade repositories, or should the Minister have this power? What checks and balances should there be on ASIC's power to grant trade repository licenses?

Please elaborate on the rationale for the proposal for ASIC to grant licenses to trade repositories, as contrasted with the position in regard to clearing and settlement facility licences and market licenses where the authority to grant such licences is conferred upon the Minister.

Question 28: Should any requirements be imposed on trade repositories with respect to obligations to provide third parties with access to the information (subject to authorisation from data providers and regulators)?

We believe that the key requirement is that the trade repositories must obtain the informed consent of the data providers before providing any such access.

Question 29: Do you have any initial views on the property rights in trade information passed to trade repositories?

Trade repositories should not acquire any property rights in the data provided or in any collation or analysis by them of the data provided. The data provided should belong to the data providers. Any collation or analysis by the trade repository of the data provided should be for the purpose of meeting a request for access by the relevant regulator or to fulfil a public disclosure requirement. As such, the trade repository should not derive any commercial benefit from the data provided or from any collation or analysis of such data.

Question 30: Are there any reasons why the location requirements being developed for FMIs should not be applied to trade repositories? If so, are there alternate approaches you prefer?

Unlike CCPs, there is no risk that trade repositories will default. Thus, the location requirements being developed for FMIs should not be applied to trade repositories on the same basis as for CCPs. The concerns with trade repositories centre on data security and confidentiality. So long as the foreign trade repository is licensed and regulated by a regulator that sets standards that will result in outcomes that are broadly equivalent to Australia's, and that regulator has established oversight arrangements with the Australian regulators, that should suffice.

6. ANTICIPATED FUTURE CONSULTATION PROCESSES

Question 31: Do you agree with the factors identified in section 6.2 for ongoing derivatives markets assessments?

Yes.

Question 32: Are there other factors that should also be included?

Please refer to our response to Question 18 above.

Question 33: Do you have any comments on the rule-making power that will be available to ASIC?

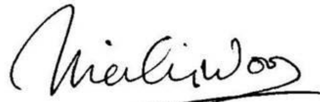
Please refer to our responses to Question 6, 7 and 8 above.

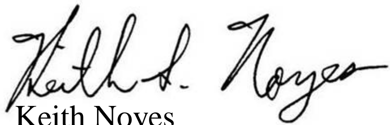
Question 34: Do you have any preliminary views on matters to which DTRs should apply?

Other than as set out in this letter, no.

ISDA appreciates the opportunity to provide comments on the Consultation Paper and looks forward to working with you as you continue 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
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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

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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

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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 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 Pickel
Executive Vice Chairman

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

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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].

[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.

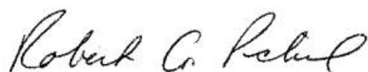
The Commission has proposed in Rule 39.5 that DCOs benefit from a presumption of eligibility to clear a swap that falls within a group, type, class, or category of swaps that the DCO is already authorized to clear. To some extent the issues raised by this proposal depend heavily on how broadly the Commission 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

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".

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[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

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[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.

[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

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[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.

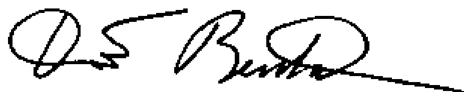
* * *

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
President
FIA



Kenneth E. Bentsen, Jr.
EVP, Public Policy and Advocacy
SIFMA

[21] MiFID II, Article 27, p. 46.

APPENDIX 3

OTC Derivatives Regulators Forum - Range of Access to Information stored in The Warehouse Trust LLC dated June 2010

Range of Access to Information stored in The Warehouse Trust LLC[1]

Regulatory access to information stored in trade repositories for over-the-counter (OTC) derivatives is critical to various authorities to carry out their respective mandates and legal responsibilities.[2]

This document aims to identify data that regulators around the world expect to request from The Warehouse Trust, a global trade repository for credit derivatives. Regulators should actively and mutually support each other's access to data in which they have a material interest in furtherance of their regulatory and/or governmental responsibilities, regardless of the particular corporate charter or geographic location of a repository. At the same time, any regulatory consensus on such data sharing should not be seen as limiting an individual regulator from obtaining other data for which it has the lawful responsibility and authority to obtain directly from a given repository. The guiding principles below are intended to help ensure that the relevant financial authorities have appropriate access to the data that they require.

This is not a legally binding document nor does it supersede or replace any other extant authority. It will be used to provide guidance to The Warehouse Trust in order to establish a transparent process by which relevant financial authorities may directly access the credit derivatives data maintained in the Warehouse Trust pursuant to the principles outlined below. Nevertheless, there will be instances where regulators may use other means to obtain data from Warehouse Trust or request data that is outside the scope of or not reflected in this guidance.

Guiding Principles

The information needs and levels of access to data will vary depending on responsibilities and statutory or other legal authority.

- Authorities, including central banks, prudential supervisors, resolution authorities and market regulators, with a material interest in credit derivatives information in furtherance of their regulatory and/or governmental responsibilities should have unfettered access to the relevant data, irrespective of the location of the trade repository.
- The scope of data access should be comparable for similarly situated authorities. However, this is without prejudice to the authority of the primary regulator or any other authority with jurisdiction over the trade repository as any such authorities need to retain their statutory authority to access any information they need to be able to carry out their statutory responsibilities. The primary regulator would not generally access participant specific data for trades where both counterparties are outside of its supervisory jurisdiction.
- Authorities accessing data in the trade repository must have the legal right and ability to keep the data confidential. This would not prohibit authorities from disclosing data if required to do so by law.
- These principles will be satisfied to the extent permitted by applicable data privacy and confidentiality laws.

Using these principles as guidance, the following table is illustrative of the various authorities that are likely to seek information from The Warehouse Trust and proposes criteria for the types of data to which regulators would have access. This table is provided only to indicate the types of information that would be covered and is not exclusive.

This document will be provided to The Warehouse Trust as guidance for responding to individual requests of authorities to access and receive credit derivatives data. A requesting authority would make formal data requests directly to The Warehouse Trust by affirming that the authority has a material interest in the information being requested in furtherance of its regulatory and/or governmental responsibilities. Warehouse Trust will work directly with the requesting authority to determine the practical procedures for accommodating its request. In addition, through the OTC Derivatives Regulators' Forum, common data reporting formats and periodic data reports are being discussed for authorities that would like to receive data relevant to their responsibilities on a periodic basis.

[1] This document is intended to provide guidance to The Warehouse Trust; however, the underlying principles might also be used to inform guidance for other global trade repositories as well.

[2] The terms "regulators" and "authorities" are used interchangeably and are intended to encompass public sector financial authorities including central banks, securities and market regulators, and prudential supervisors of market participants that would have a material interest in credit derivatives data in furtherance of regulatory and/or governmental responsibilities.

Authority	Definition	Potential Data Requests*
Market Regulator	A national government entity or equivalent that, through legal mandate, has responsibilities in the jurisdiction in which it is domiciled to maintain market stability and integrity, and/or investor protection. Such responsibilities may be carried out through: • Surveillance activities, including, looking at market patterns/characteristics in the markets to determine where there are potential risks/concentrations in the underlying positions. • Fraudulent activity/financial crimes detection (e.g. insider trading). • Oversee inspection of market participants (securities firms, brokers, investment advisers, ratings agencies, etc). • Enforcement, including specific actions against market participants.	• Transaction/position level data for counterparties in its jurisdiction/market it oversees, including market intermediaries for which it acts as a primary supervisor. • Transaction/position level data for all cleared and uncleared contracts written on a specific reference entity, industry and/or region related to the market regulated by the authority, regardless of the location of the counterparties.
Possible Example **United States Securities and Exchange Commission**	The mission of the SEC is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The SEC is responsible to: interpret federal securities laws; issue new rules and amend existing rules; oversee the inspection of securities firms, brokers, investment advisers, and ratings agencies; oversee private regulatory organizations in the securities, accounting, and auditing fields; and coordinate US securities regulation with federal, state, and foreign authorities *www.sec.gov*	• Transaction level data for US market participants bought/sold to other US market participants on any reference entity. • Transaction level data for US market participants bought/sold to non US participants on any reference entity. • Transaction level data for non US participants bought/sold to non US participants on US reference entities.
Central Bank	A central bank, reserve bank, or monetary authority may issue currency, regulate the supply of credit, hold the reserves of other banks, sell new issues of securities for the government, maintain financial stability and oversee payment systems and market infrastructure. Such authorities have responsibilities that may include: implementing monetary policy; determining interest rates; controlling the nation's money supply; acting as the Government's banker and the bankers' bank; acting	• Aggregate notional data for all trades in the currency of the authority and/or settled in its currency, including breakdown by reference entity and/or sector. • Aggregate notional data, in its country's currency, for each of the top [10] counterparties active in that currency. • Aggregate notional data for contracts written on each reference entity in its jurisdiction, including the top [10] aggregate positions for each reference entity. • Top [10] counterparty positions where the authority's sovereign debt is a reference obligation.

Authority	Definition	Potential Data Requests*
	as lender of last resort; managing the country's foreign exchange and gold reserves and the Government's stock register, and ensuring the robust functioning of financial intermediaries, markets and market infrastructures to promote financial stability *If a central bank also has supervisory powers, or a capacity to obtain participant and/or transaction level information, scope of access in that capacity will be covered separately below.*	• Top [10] counterparty positions per reference entity, where the reference entity is one of the [10] largest financial groups in its jurisdiction. • Top [10] counterparty positions for each of the [10] largest financial groups in its jurisdiction. *Top [10] counterparties will be determined by notional volume.*
Possible Example **Bank of Italy**	The Bank of Italy is the central bank of the Republic of Italy and part of the European System of Central Banks and the Euro system. The main functions of the Bank are to ensure monetary and financial stability. The Bank's responsibilities include monetary policy, foreign exchange market and official reserves, operations on behalf of the Ministry for the Economy and Finance, investment portfolio, market supervision, payment system oversight, treasury functions, note issues, research and international relations, supervision. *www.bancaditalia.it*	• Aggregate data for all contracts traded or settled in the euro. • A list of top 10 counterparties trading euro denominated contracts with each counterparty's aggregate notional position. • Aggregate notional data for contracts written on an Italian reference entity, including a list of the top 10 aggregate notional counterparty positions for contracts written on each reference entity. • A list of the top 10 counterparties' aggregate notional positions where contracts reference the debt of the Republic of Italy. • A list of the top 10 counterparties aggregate notional positions where contracts reference one of the five largest financial groups in Italy. • A list of the top 10 counterparty positions for each of the five largest financial groups in Italy.
Prudential Supervisor / Authority Responsible for Facilitating Resolution of Failed Institutions	A national government entity or equivalent that has direct statutory authority to supervise and regulate or to monitor and conduct surveillance on, or resolve financial institutions (banks, financial services providers, insurance providers, securities firms etc.) and ensure a safe banking system. This may include enforcing laws and establishing rules to protect banking depositors and other customers.	• Transaction level data for each participant regulated by the authority, for own account and/or on behalf of customers. • Aggregate notional counterparty positions and transaction level data for contracts written on a regulated entity, regardless of the location of the counterparties.

Authority	Definition	Potential Data Requests*
Possible Example **Japan FSA**	The FSA is responsible for ensuring the stability of Japan's financial system, protection of depositors, insurance policyholders and securities investors, planning and policymaking concerning the financial system, inspection and supervision of private sector financial institutions and surveillance of securities transactions. Through its Securities and Exchange Surveillance Commission branch the FSA is also responsible for market regulation. *www.fsa.go.jp/en*	• Transaction level data for Japanese institutions bought/sold to other Japanese institutions on any reference entities. • Transaction level data for Japanese institutions bought/sold to non Japanese institutions on any reference entity. • A list of aggregate notional counterparty positions where contracts reference regulated Japanese institutions, where one or more counterparties may be non-Japanese institutions. *Japan FSA would only receive data for those financial institutions which it regulates or for* contracts *written on an institution it regulates.*
Systemic Risk Regulators	A financial authority mandated to oversee the entire financial system of a given jurisdiction and identify emerging risks.	Aggregate global data.
Law Enforcement Authorities		Law enforcement authorities would have restricted access based on legal necessity through the normal legal channels.
Other Authorities		Other interested authorities not listed above can access data by directly contacting relevant regulators in their jurisdiction or the institutions in their jurisdiction that are participants in trade repositories and in accordance with the applicable regulations in the relevant jurisdiction.. In addition, they will have access to any public data made available by the trade repositories.

** There are three classifications of data provided in the table above. The most granular is transaction level data, which includes individual trade details. The next is position level data, which includes aggregate position data for individual counterparties. The last is aggregate notional data, which would not provide counterparty details. An authority that receives transaction level data would thereby also have access to position level and aggregate data. Further breakdowns of this data (e.g. geography, sector, notional bought/sold, maturity) will be available to authorities as needed and as applicable to the interests outlined above.*