

ISDA® News

A round-up of news and developments from the
International Swaps and Derivatives Association

Issue 5, 2010

BASEL COMMITTEE

Consultation on counter-cyclical buffers; meeting to refine capital rules

The Basel Committee has opened a new consultation on counter-cyclical capital buffers. In this proposal, banks would be required to hold an extra capital buffer above the minimum. This amount would be determined pro rata by the country of origin of the bank's loan portfolio, with each country setting a level to be used for all loans originated there. The consultation ends on the September 10, and ISDA has convened a group to respond.

The Committee also met in mid-July to refine the capital rules originally proposed in December 2009. They based their work on comment letters received, including ISDA's, a quantitative impact study (which was in certain areas followed by additional mini-studies), and a further study completed by various subcommittees over the past few months in conjunction with various bodies including ISDA. A full revision of the rules is not expected to be available until the autumn.

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PUBLIC POLICY

US: Dodd-Frank technical amendments likely

Dodd-Frank has been signed into law by President Obama. House Financial services Committee Chairman Frank and Senate Banking Committee Chairman Dodd have conceded that additional fixes are necessary, likely through separate legislation making "technical" amendments. It is currently unclear when such legislation will be introduced. In the meantime, the implementing agencies, led by the CFTC and SEC, will begin the implementation process through a series of rule-makings, the majority of which are required within 360 days of enactment.

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Europe: ISDA responds to EC consultations on CCPs, repositories and short selling

On July 9, ISDA submitted its [response](#) to the EC, jointly with the Association for Financial Markets in Europe (AFME) and the British Bankers' Association, on a consultation paper regarding [market infrastructures and derivatives regulation](#) (EMIR). ISDA also provided a [response](#), jointly with AFME and International Securities Lending Association, on another EC consultation on [short-selling and CDS](#). Based on these consultations, EC proposals for legislative texts are expected on September 8.

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A WORD FROM THE CEO



Conrad Voldstad
Chief Executive Officer

Moving forward in response to ISDA's Member Survey

In the first half of the year, ISDA conducted a survey to see what members liked and, more importantly, what they thought needed improvement in the Association's offerings. Out of over 820 members, we heard back from nearly 500, which is a great response rate. We thank all of you who participated.

Overall, respondents view ISDA as an effective organization, are pleased with their membership and believe that ISDA's value compares favorably to that of other associations. They value our work and initiatives in a number of areas, including documentation, legal opinions, collateral, clearing, regulatory matters, operational infrastructure and Basel capital issues. We are very pleased with the overall message from members.

There were, of course, areas of relative weakness. These included research and analysis and support for investment and financial firms. Respondents also thought ISDA should encourage greater member involvement in its activities.

So what are our takeaways and plans in light of the survey?

We shouldn't change the fundamentals — and indeed we will continue to build on core strengths in documentation, legal and support of the main derivatives asset classes. Next, we need to reach out more pro-actively to members. To this end, we have started hosting regulatory conference calls for all members, and will continue to run these on a regular basis. We are redesigning our website to deliver a more user-friendly and easily-navigated experience by year-end. We are adding staff to interface more directly with members. We are having meetings with investment firms to better determine what services we should offer them. We have added analytical resources in London, and are studying the best way to offer research globally.

The survey contained much good news and we thank the membership for that. But, more importantly, it gave us a sense of what we can do better and where we can go from here. As always, your insights and comments are welcome.

PUBLIC POLICY

Europe: CESR consultations on transaction reporting

On July 12, the Committee of European Securities Regulators (CESR) published a [consultation paper on its technical advice to the EC on client categorization issues](#) around the Markets in Financial Instruments Directive (MiFID) review to be launched in autumn. The paper asks whether tests of knowledge and experience should be used more widely for client categorization, whether the scope of the eligible counterparties should be narrowed for complex products (such as non-standard OTC derivatives), and what standards should apply to transactions with eligible counterparties. The consultation document also invites comments on technical criteria to further distinguish within the current broad categories of clients and questions whether local authorities can be treated as public debt bodies. ISDA will respond by the August 9 deadline.

On July 19, CESR launched consultations on transaction reporting and OTC derivatives, and another on standardization and exchange trading of OTC derivatives. CESR findings will inform future European Commission draft proposals for legislation addressing such requirements.

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COMMENT



Robert Pickel
Executive Vice Chairman

Industry concerns in the wake of Dodd-Frank

The ink is barely dry on the Dodd-Frank Wall Street Reform and Consumer Protection Act which overhauls US financial regulation. Title VII of the 2,300-page Act deals with derivatives and specifies profound changes to the marketplace once the new rules are written over the coming months. We at ISDA will offer input to regulators with respect to market practices, product definitions, legal questions and many other issues.

We have been in favor of much of what the Act has now set into law, such as reducing counterparty credit risk through increased use of clearinghouses and reporting transaction information to regulators through data repositories. That said, serious concerns remain:

- *Treasury determination regarding foreign exchange.* The law provides that the US Treasury may exempt foreign exchange swaps and forwards from the legislation and specifies a number of considerations which the Treasury must use in making that determination. The foreign exchange markets already work very well and their risks are well-managed. If swaps and forwards will have to be cleared and traded on exchanges, much work will need to be done at a time when resources will be stretched.
- *Push-out provisions.* The push-out provisions could affect non-US banks that operate in the US, as well as non-bank entities that currently trade derivatives both in the US and elsewhere.
- *Definition of SEFs.* SEFs are swap execution facilities and they, together with exchanges, will likely be the primary means of executing swaps that must be cleared. The industry needs guidance on what facilities will qualify, what rules will govern SEFs and how they will work in a practical sense. The final definition of SEFs should be guided by the need to preserve liquidity and flexibility.
- *Preservation of market liquidity.* Requiring swaps that must be cleared to be executed on an exchange may inhibit liquidity in a number of ways. Executing large transactions on an exchange is sure to move markets and block trading exemptions will need to be established. As clearing capabilities grow, trades with broken dates, unusual structures or indices could be sent to clearinghouses. Market-making would provide better pricing for these transactions than exchange-trading.
- *Robustness of CCPs.* As CCPs (central counterparties or clearinghouses) grow in size, they may create systemic risk if they are not managed and regulated properly. We have specific ideas on how they can operate safely.
- *International harmonization.* Europe will soon introduce legislation and increased regulation. We will monitor the differences in laws and regulations and notify policymakers and our membership of significant differences and likely effects.
- *Clarity on margin for exempt end-users.* We have been open about our concerns that the deletion of certain language in the statute regarding margin exemptions for US end-users could lead to the imposition of margin on corporations. That would increase the cost of hedging and create significant funding issues for many companies.

This is a current list of priorities, but others may arise as rule-making progresses.

TRADING INFRASTRUCTURE

Collateral: infrastructure meeting with UK FSA

A meeting with regulators and members of the ISDA Collateral Steering Committee was held at the UK Financial Services Authority (FSA) on June 29. The discussion included the desirability and feasibility of a spectrum of potential central collateral infrastructure elements ranging from central exposure calculations, collateral calculations, collateral calls, and centralized multilateral collateral payments and net-down. The steering committee presented a proposal aimed at improving regulators' access to data on the largest exposures of the top 50 or so market participants by volume.

Best practices in OTC derivatives collateral

ISDA published a document entitled *Best Practices for the OTC Derivatives Collateral Process* on June 30. The Best Practices are the result of the collaborative efforts of a working group of buy-side and sell-side market participants, under the auspices of the ISDA Collateral Steering Committee. The detailed document, which will be updated by the Collateral Steering Committee on a periodic basis, provides guidance on current best practices for the collateral management process. The document is available on the Collateral Committee section of the ISDA website.

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Transparency updates

ISDA submitted an updated version of the transparency credit study to the supervisors. Discussions have started in the rates and equity transparency subgroups with regard to similar studies for those asset classes. Discussions are ongoing with the supervisors to define the data for the third deliverable: submission of data to the regulators to allow them to do their own analysis on transparency.

A July 16 call with the New York Federal Reserve discussed data anonymity. The Fed will consult with the other supervisors on the suggested way forward, which is for the primary regulators for each of the G14 institutions to formally request the data from that institution.

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FINANCIAL LAW REFORM

Bank insolvency proposal in Germany

The German Ministries of Justice and Finance have published a joint [draft proposal](#) to introduce new provisions on bank insolvency. The new draft proposal consolidates earlier drafts from autumn 2009. Some of the key draft provisions address issues such as termination of financial contracts upon regulatory intervention to ailing and failed banks, as well as partial transfer powers (i.e. the power to replace a failing bank counterparty with a new counterparty or a bridge bank). ISDA has commented on the draft proposal.

EC publishes Green Paper on European Contract Law

ISDA has been monitoring efforts at the EU Commission level to create a single European contract law since 2003. Potentially, such a regime would extend into cross-border capital market transactions, such as those under an ISDA Master Agreement (for example, as a "28th" legal regime which exists in parallel to the legal regimes of each EU member state). Initially, the focus was on consumer protection issues in business-to-consumer transactions, but over time business-to-business transactions grew likely to be addressed.

This month the Commission published a Green Paper, [Policy options for progress towards a European Contract Law for consumers and businesses](#), thus launching a consultation gathering views from relevant stakeholders. The paper notes that differences between national contract laws may entail additional transaction costs and legal uncertainty for businesses and lead to a lack of consumer confidence in the internal market. It discusses the various options for the legal format of the law: from EU directives and regulations; to a toolkit that would provide "inspiration to legislators" in the area of contract law; to optional instruments that are roughly comparable to the UN Convention on the International Sales of Goods (which affects a number of physically settled derivatives transactions). The Commission has invited comments on the green paper by January 31, 2011, and depending on the results of the consultation, could propose further action by 2012.

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ACCOUNTING

IFRS convergence dates adopted in India

The Indian Ministry of Corporate Affairs has set dates for the convergence of Indian Accounting Standards with IFRS for insurance companies, banks and non-bank financial institutions. Banking companies will have a phased introduction commencing with the opening balance sheet on April 1, 2013; some urban co-operative banks (depending on net worth) and regional rural banks will be exempt. Non-banking financial companies (NBFCs) will have a phased introduction commencing the same day, with some unlisted NBFCs exempt (depending on net worth). Other companies will have a phased introduction commencing April 1, 2011, with some unlisted companies (depending on net worth) and small and medium companies exempt.

Fair value measurement exposure drafts

On June 29, the FASB issued an exposure draft on Fair Value Measurement and Disclosure Requirements in US GAAP (Topic 820) and IFRS. The proposal sets forth amendments that the Boards believe would improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with US GAAP and IFRS.

On June 30, IASB published an exposure draft with a proposal on *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements* which is the same as a proposed disclosure requirement on Topic 820 by the FASB. Both Boards will jointly consider comments as they continue their discussions about fair value measurement after the exposure periods end. ISDA will submit comments to these exposure drafts by the deadline of September 7.

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ISLAMIC FINANCE

Saudi Arabia meetings on Tahawwut Master Agreement

ISDA and the International Islamic Financial Market (IIFM, co-publisher of the Islamic version of the ISDA Master Agreement) met with a number of Saudi banks to discuss the ISDA/IIFM Tahawwut Master Agreement and its use by Saudi market participants. Particular emphasis was put on the need to enhance the legal and regulatory framework for all types of capital market transactions in Saudi Arabia. The associations have initiated approaches to the Saudi central bank (SAMA), and the Saudi financial markets regulator (CMA).

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CENTRAL & EASTERN EUROPE

Russia: meeting on draft netting legislation

ISDA met with the Deputy Head of the Federal Financial Markets Service of the Russian Federation (FSFM) in July to discuss the contents of draft netting legislation. FSFM serves as the lead regulator on all matters regarding OTC derivatives in Russia, and is currently in the process of drafting netting legislation with possible adoption by the Lower House by year-end. ISDA provided input on uncertainties that currently affect OTC derivatives transactions, especially discrepancies stemming from divergent wording in the Russian Civil Code (anti-wagering provision) and the new Securities Markets Law (status of qualified investors and types of transactions), as well as related tax provisions.

Slovakia: submission to Ministry of Finance

ISDA and the European Federation of Energy Traders made a joint submission to the Slovak Ministry of Finance, including draft proposals to amend existing netting and collateral legislation. The proposals aim to widen the scope of counterparties eligible for netting and collateral arrangements to include corporate entities. Another goal is to include physical commodity transactions in the scope of transactions eligible for close-out netting.

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Hong Kong: FSTB conclusions on corporate rescue

The Financial Services and the Treasury Bureau (FSTB) issued consultation conclusions on the *Consultation Paper on the Review of Corporate Rescue Procedure Legislative Proposals* of July 9, 2010. Under clause 11(2)(f) of the *Companies (Corporate Rescue) Bill* (the 2001 Bill), any set-off would be disallowed except with the consent of the provisional supervisor or in relation to certain exempted financial contracts. In the conclusions, the FSTB proposes to remove the general prohibition against set-off. Regarding the exempted financial contracts, the FSTB believes the exemption list approach should be retained and the list of contracts to be included should be updated in the light of market developments since the 2001 Bill. The FSTB also concluded that the revised list may be introduced in the form of subsidiary legislation to facilitate further updates in the future. ISDA will continue assisting the FSTB in revising and updating the list of exempted derivatives transactions.

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India: new collateral opinion

On July 14, ISDA announced the publication of a new collateral opinion from Indian counsel, Juris Corp. The opinion is available in the Members' Portal of www.isda.org, in the Opinions and Legislation section.

New Zealand: ISDA submission on securities law

ISDA circulated a draft submission on the Ministry of Economic Development's Discussion Paper on Review of Securities Law to members on July 20 for feedback and comments. The new securities law regime proposes to regulate financial products for which generating a financial return or hedging financial risk is a material feature, including OTC and exchange-traded derivatives. The deadline for the submission is August 20.

Indonesia: offshore product agency memo, FX drafts

On July 5, ISDA circulated a memo to members summarizing the impact of Bank Indonesia (BI) Regulation No. 12/9/PBI/2010 – *Prudential Principles in Conducting Offshore Financial Product Agency Activity by Commercial Banks*, which came into force on June 29. On July 7, ISDA circulated English translations of the BI Regulation, Elucidation and FAQs to members. In brief, Indonesian commercial banks (including Indonesian branches and subsidiaries of foreign banks) cannot be involved in any activity regarding offshore financial products without getting prior approval from Bank Indonesia and complying with the requirements set out in the Regulation. While it is clear that the Regulation does apply to offshore-booked OTC derivatives as well, what remains unclear is whether this is limited to OTC derivatives which are structured products (as defined in Bank Indonesia Regulation No. 11/26/PBI/2009) or extends also to plain vanilla OTC derivatives. ISDA is working with active onshore members to obtain clarification from Bank Indonesia.

On July 12, ISDA circulated drafts of the confirmation templates, FX Glossary and Rates Glossary to members. The templates cover Deliverable USD/IDR FX spots, FX forwards and FX swaps, put and call currency options, and binary currency options, and Deliverable and Non-Deliverable USD/IDR interest rate and cross currency swaps. ISDA will proceed with translations of the templates into Bahasa Indonesian to facilitate members' compliance with the requirements of Law No. 24 of 2009.

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ASIA PACIFIC

Malaysia: call, submission on Consultation Paper

ISDA held a call on July 9 regarding the Consultation Paper issued by the Malaysia Deposit Insurance Corporation on *Proposed Amendments to the Malaysia Deposit Insurance Corporation Act 2005 Affecting Certain Financial Transactions*. Following the call, ISDA circulated a draft submission on the Consultation Paper to members on July 13 for feedback and comments. The deadline for the submission is July 30.

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Credit derivatives historical succession event briefing

On July 14, ISDA held a call on AEJ and ANZ historical succession events for APAC credit operations members. ISDA provided background on the historical succession events and advised that the relevant Determination Committee is about to review these events. Members were asked to contact ISDA should they identify any operational issue relevant to such events that could impact the priority order in which the DC analyzes the events.

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RESEARCH

Speculation is topic of next issue of Research Notes

Speculation, especially in the form of short selling, has long been a subject of controversy, and that appears to be happening again. At the height of the financial crisis in late 2008, the US Securities and Exchange Commission imposed a temporary ban on short selling of the stocks of certain financial institutions. Now, in the European Union, French President Nicholas Sarkozy and German Chancellor Angela Merkel have called for a ban on naked credit default swaps on sovereign bonds as well as naked short selling of the bonds.

Shorting is not the only target: when oil prices rose sharply during the summer of 2008, for example, many observers claimed that speculators, and not fundamental factors, were behind the increases. Although subsequent analysis invariably finds that speculation was not the primary cause of price changes, speculators are a handy target.

The next issue of ISDA Research Notes, *Speculation and Financial Markets*, will summarize some themes in economic research that are relevant to speculation. The Note, based on the economic literature on “market microstructure,” will consider the contribution speculation makes to financial markets in three areas. First, speculators—along with dealers—enhance market liquidity by making markets deeper and by making it possible to complete transactions rapidly. Second, speculators enhance market efficiency by identifying and taking positions on assets that are either overpriced or underpriced. And finally, speculators make markets more complete by expanding the hedging opportunities available to other market participants.

Given the contribution speculators make to the functioning of markets, it is likely that restricting short selling or other forms of speculation could have unintended consequences that make hedging more costly. ISDA Research Notes are available at <http://www.isda.org/researchnotes/isdaresearch.html>.

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JAPAN

METI publishes exposure draft on Commodity Futures and Exchange Act

Ministry of Economy, Trade and Industry (METI) has published an [exposure draft](#) (in Japanese) of government ordinance to the revised *Commodity Exchange Act* (renamed the *Commodity Futures and Exchange Act*) that was promulgated in July 2009. The law is being implemented in three stages:

1. Expansion of rules on unfair trading, such as manipulation of off-exchange transactions, are punishable by a criminal penalty (implemented on October 8, 2009);
2. Deregulation of exchanges, which allows commodity exchanges to expand their scope of business into financial instruments (implemented on July 1, 2010);
3. Introduction of cross-sectional rules between on-exchange and OTC transactions. Brokers dealing in OTC transactions will be required to have a license, depending on client size. Transactions with non-professionals will be subject to the conduct of business rules such as suitability and duty of explanation, prohibition of loss compensation and cold calling (to be implemented on January 1, 2011).

The published exposure draft covers the third stage that will have the most significant impact on OTC commodity derivatives market. The draft ministry ordinances relating to the third stage will also be published soon. The draft government ordinance is open for comments until August 13.

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AUCTIONS & DETERMINATIONS COMMITTEE

Truvo Subsidiary Corp.

The auction to settle the credit derivatives trades for Truvo Subsidiary Corp was held on July 15. The auction was administered by Creditex and Markit and results can be found on www.creditfixings.com

iTraxx LevX Market Makers voted later to hold an auction for European loan-only CDS transactions referencing certain loans of Truvo USA LLC. The auction terms will be determined by the Markit iTraxx LevX Market Makers according to the ELCDS Auction Rules. The auction will be administered by Markit and Creditex. Further details can be found on the [ISDA website](#). This auction is separate to and distinct from the auction held on July 15 in respect of CDS transactions referencing Truvo Subsidiary Corp.

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Name change decision reached on ERAC USA

Pursuant to Section 3.8 of the Determinations Committees Rules, the Americas DC voted on July 13 that the corporate events related to ERAC USA Finance Company's conversion into ERAC USA Finance LLC on July 31, 2009 should be treated as a name change. This was the first instance that the DC relied on its interpretive powers under this provision in the Rules. To provide additional transparency to the market, the DC also published a statement detailing the facts that were considered prior to reaching its conclusion. Please refer to the resolutions found [here](#) for further details.

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ISDA[®]

Conferences

To register for these conferences or find out more information, visit:
<http://www.isda.org/conf/>

August 4, 2010	<u>Understanding the ISDA Master Agreements Conference</u> Beijing	September 14, 2010	<u>Fundamentals of Derivatives Seminar</u> New York
August 5, 2010	<u>Understanding Collateral Arrangements and the ISDA Credit Support Documents Conference</u> Beijing	September 15, 2010	<u>Understanding the ISDA Master Agreements Conference</u> New York
August 16, 2010	<u>Understanding the ISDA Master Agreements Conference</u> Singapore	September 16, 2010	<u>2010 ISDA Regional Conference</u> New York
August 17, 2010	<u>Understanding Collateral Arrangements and the ISDA Credit Support Documents Conference</u> Singapore	September 21, 2010	<u>Understanding Collateral Arrangements and the ISDA Credit Support Documents Conference</u> New York
August 18, 2010	<u>Documenting and Confirming Rate and FX and Currency Option Transactions Conference</u> Singapore	September 21, 2010	<u>2010 ISDA Regional Conference</u> London
August 25, 2010	<u>Fundamentals of Derivatives Seminar</u> Johannesburg	September 22, 2010	<u>Counterparty Credit Risk Seminar</u> New York
August 26, 2010	<u>ISDA Documentation Conference</u> Johannesburg	September 22, 2010	<u>Fundamentals of Derivatives Seminar</u> London
September 7, 2010	<u>Understanding the ISDA Master Agreements Conference</u> Hong Kong	September 23, 2010	<u>Understanding the ISDA Master Agreements Conference</u> London
September 8, 2010	<u>Understanding Collateral Arrangements and the ISDA Credit Support Documents Conference</u> Hong Kong	September 24, 2010	<u>Understanding Collateral Arrangements and the ISDA Credit Support Documents Conference</u> London
		September 28, 2010	<u>ISDA Symposium - UK Bank Special Resolution Regime</u> London