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ISDA, EBF, ICMA and ISLA Publish Whitepaper on the Benefits of Post-trade Risk Reduction Services

LONDON, April 10, 2018 - The International Swaps and Derivatives Association, Inc. (ISDA), the European Banking Federation (EBF), International Capital Market Association (ICMA) and the International Securities Lending Association (ISLA) have today published a whitepaper on the benefits of post-trade risk reduction services as a crucial risk management tool.

Post-trade risk reduction services like compression and counterparty rebalancing play an increasingly important role in reducing risks in derivatives markets. Compression, for example, results in offsetting trades between multiple parties being torn up, which reduces the size of gross derivatives exposures, in turn reducing systemic risk.

These risk-mitigating benefits are recognized in the European Union (EU) under the revised Markets in Financial Instruments Directive and its associated regulation (MIFID II/MIFIR), which exempt post-trade risk reduction administrative transactions from the trading obligation. There is, however, currently no exemption from the clearing obligation in the EU for these transactions. The failure to recognize these strictly non-trading and market risk neutral administrative transactions within the European Market Infrastructure Regulation (EMIR) limits systemic risk reduction in derivatives markets.

In the paper, ISDA, the EBF, ICMA and ISLA recommend that EMIR be amended as part of the Regulatory Fitness and Performance Program, or REFIT, to exempt transactions resulting from post-trade risk reduction services from the clearing obligation, or to empower the European Securities and Markets Authority to do so.

"Post-trade risk reduction has become an essential risk-management tool for the derivatives market, resulting in hundreds of trillions of euros in derivatives risks being removed. An exemption from the EMIR clearing obligation for transactions resulting from post-trade risk reduction would help further reduce systemic risk," said Roger Cogan, Head of European Public Policy at ISDA.

"Collateral in the form of margin is an essential risk management tool, but rather than over rely on this mechanism, it makes sense to better facilitate post-trade risk reduction and so reduce aggregate exposure levels," said ICMA Chief Executive Martin Scheck.

"Recognizing the risk reduction benefits of compression – for example, reducing counterparty risk and therefore systemic risk – is critical when considering amendments to EMIR," said Mark Hutchings, Chief Operating Officer at ISLA. "For securities lending, post-trade risk reduction like compression will bring with it efficiencies such as less collateral being called, which will ultimately improve collateral liquidity and reduce collateral costs."

The Associations make the following recommendations on conditions for satisfying any exemption.

- They should be **market risk neutral:** They are designed to not change the directional market risk of the portfolios concerned, but rather reduce counterparty, operational and systemic risk in respect of existing derivatives transactions.

- They should be **non-price forming:** While they may involve a new legal transaction (rather than a trading transaction) in order to achieve the identified risk reduction result, participants are not able to post bids or offers, no price negotiation takes place and market risk neutrality means transactions are recorded away from market prices on stale curves.

- They **should address second-order portfolio risks:** They do not offer a vehicle for taking market positions or entering into trading transactions. Their purpose is the reduction of operational, counterparty and systemic risk.

- **Single multilateral compound transaction:** The risk-reduction cycles are binding on an all or nothing basis across all cycle participants and the transaction components are executed as a single compound bulk legal transaction.

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About ISDA
Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 875 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org, Twitter: @ISDA

About EBF
The European Banking Federation is the voice of the European banking sector, bringing together 32 national banking associations in Europe that collectively represent some 3,500 banks – large and small, wholesale and retail, local and international – employing approximately two million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 400 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth. www.ebf.eu @EBFeu

About ICMA
ICMA is the trade association for the international capital market with over 530 member firms from 60 countries, including banks, issuers, asset managers, infrastructure providers and law firms. It performs a crucial central role in the market by providing industry-driven standards and recommendations for issuance, trading and settlement in international fixed income and related instruments. ICMA liaises closely with regulatory and governmental authorities, both at the national and supranational level, helping to ensure that financial regulation promotes the efficiency and cost effectiveness of the capital market. www.icmagroup.org

About ISLA
ISLA is a trade association which represents the interests of participants within the securities lending and borrowing markets. Formed in 1989, ISLA has over 140 members comprising of asset managers, banks, insurance companies, pension funds, securities dealers and service providers. The ISLA team now consists of five full-time staff and are guided by an elected board of fifteen professionals who represent firms from all parts of the industry globally.
ISLA’s aims include: working with regulators to provide a safe and efficient framework for securities lending; highlighting new market developments; ensuring sound industry practices; enhancing the public profile of the securities lending industry; fostering good communication and co-operation with other trade associations; promoting the use of the Global Master Securities Lending Agreement (GMSLA) as the market standard legal agreement. www.isla.co.uk