ISDA Safe, Efficient Markets

Understanding risk management and liquidity in Single Name CDS and what this means for the MIFIR transparency regime

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Executive Summary

- Recent comments from an influential European regulator have focused on issues perceived regarding Credit Default Swap (CDS) markets during the market turmoil following the issues faced by SVB and Credit Suisse, and particularly in relation to a specific CDS trade referencing Deutsche Bank, executed at an off-market price[1]. Some of these concerns are the subject of further exploration by the European Commission (EC) including regarding the level of market transparency applied to Single Name (SN) CDS.
- In this paper, we address the substance of these concerns. We also address some of the key characteristics of the SN CDS market, and what these characteristics tell us about the level of (public) transparency that is appropriate to SN CDS business.
- ISDA supports the application of a level of (public) transparency that is appropriate to the liquidity characteristics of SN CDS business. While ISDA believes there is room for improvement in the MIFIR transparency regime as detailed at MIFIR Levels 2 and 3, ESMA's assessment that SN CDS are illiquid for MIFIR (public) transparency purposes is fundamentally correct.
- To underline this support for *appropriate* public transparency requirements to SN CDS, ISDA and its members have analysed the liquidity of SN CDS by reference to a global data set, and formulated a draft (public) transparency regime that would be

[1]The emphasis on the off-market price of the trade may well be misplaced. The CDS trade in question may have been subject to a volume cap. SN CDS trades of a volume of $5 million or more are 'volume capped' under SEC rules, meaning that the trade report mentions the $5 million volume cap, but not the actual volume of the trade. As such, it is not necessarily accurate to say that this trade was executed at an off-market price. It is possible that the liquidity provider in this instance priced in a premium for acting as counterparty in this trade, if a large volume was involved (given the challenges for a liquidity provider in 'managing off' a large amount of risk).

calibrated to the levels of liquidity in the SN CDS market, sharing this analysis and draft transparency regime with policymakers in Q3 2022. We recall the substance of this work in this paper (see the concluding section herein, on **'**ISDA's data analysis on CDS liquidity, and 'strawman' appropriate transparency regime for SN CDS').

- ISDA fundamentally believes that (public) transparency is best applied to liquid instruments in order that market participants obtain insightful data. To the extent that public transparency requirements apply to SN CDS, they should be calibrated (by recourse to appropriate deferrals) based on the level of liquidity apparent regarding the trading of CDS on each reference entity. Such an approach also makes it more likely that liquidity providers can 'manage off' the risks they assume from clients in facilitating their hedging, and that liquidity providers can offer optimal prices, such that clients can hedge on optimal terms. An efficient SN CDS market also makes it more likely that the underlying bond market will function, particularly during market stress.

Clearing of CDS

- One recent view expressed by a senior regulator is that CDS should be centrally cleared. In fact, they largely are, with a clearing mandate applying to the most heavily traded index CDS contracts, and a significant share of SN CDS voluntarily cleared.
- Nevertheless, SN CDS are largely illiquid, a key consideration given that ESMA is required to take into consideration the 'volume and liquidity' of classes of derivatives when considering application of the clearing obligation. A clearing mandate for such products could have the effect of increasing systemic risk by importing exposures into the CCPs which they might have difficulty managing in a stressed environment.

Index CDS are liquid, SN CDS are accurately described as 'shallow and illiquid'

- Concern has also been expressed that CDS markets are 'shallow and illiquid'. In fact, the most high volume Index CDS *are* liquid enough to sustain the clearing *and* trading obligations under EU legislation). However, global data shows that few SN CDS contracts are traded more frequently than the 10 trades per day threshold used by ESMA to determine whether CDS should

be deemed 'liquid' and therefore subject to near real-time trade transparency. SN CDS that are traded more than 10 times per day are predominantly CDS referring to non-EU sovereign debt[2] issuers.[3]

- This pattern would be even more apparent in analysis of data on trading of SN CDS by EU (MIFIR-) scope firms. The MIFIR-scope data set would be significantly smaller than the global data set, so even fewer EU-scope SN CDS contracts would trade 10 times a day or more).
- This illiquidity is why *real-time* MIFIR trade transparency should not apply to SN CDS, the markets for which do not manifest 'ready and willing buyers and sellers on a continuous basis' (one of the ways in which MIFIR defines liquidity). If such transparency were to apply to SN CDS, it would likely further undermine liquidity in these markets, with the limited number of liquidity providers still holding out liquidity in this market facing more risk in doing so, with negative effects on the prices they would be willing to quote.
- A less liquid and less efficient CDS market would not be positive for underlying bond markets. CDS are a valuable tool through which investors can find counterparties enabling them to manage bond market risks. Miscalibrated transparency could make it more costly and difficult to hedge various bond-related risks through CDS, with the consequence that it is more likely that selling pressures will be expressed in the underlying bond market.
- ISDA believes that applying either the CFTC or SEC framework in totality in the MIFIR framework without adequate consideration would risk unintended consequences. This may also be quite challenging as some of the concepts in these rulesets (e.g., volume caps) do not exist in MIFIR. Nevertheless, the ISDA draft regime for CDS transparency previously shared with policymakers combines elements of the SEC and CFTC rules, applying an appropriate level of transparency to these markets.

The description of CDS markets as 'opaque'

- The leading index CDS contracts are subject to public transparency as they are deemed liquid. Because of the fundamental illiquidity of the SN CDS market, where market transparency does apply to SN CDS under MIFIR it is subject to a deferral.

[2] The 2012 EU Short Selling Regulation bans 'uncovered' CDS buying protection against default of EU sovereign issuers: EUR-Lex – 32012R0236 – EN – EUR-Lex (europa.eu)

[3] Q1 2023 was an outlier, in which 55 non-sovereign reference entities (in SN CDS) were traded (globally) more than 10 times per day. From Q1 to Q4 2024, just 7, 11, 16 and 11 non-sovereign CDS traded more than 10 times per day on average in each quarter.

- While SN CDS are not subject to close-to real time public transparency in the MIFIR sense, it is incorrect to describe them as 'opaque' (the other concern most prominently expressed by a leading European regulator), including in terms of information available to regulators.
- MIFIR transaction reports make all the market integrity-focused data needed by regulators available to them. This will not change under either the Council or EP version of the MIFIR text currently being revised.
- EMIR reports mean that trade repositories can provide regulators data needed to monitor build-up of systemic risk concerns.
- Furthermore, there are plentiful sources of commercial transparency regarding SN CDS available to market participants including aggregated / composite pricing, runs, Request for Quotes, End of Day notional volumes and trade counts, etc. (e.g., S&P Global, ICE, Bloomberg, Tradeweb)].

Introduction

A leading European regulator recently made a number of public remarks about trading in CDS referencing Deutsche Bank in the aftermath of the difficulties encountered by Silicon Valley Bank and Credit Suisse.

These comments focused on a number of concerns:

1. Single Name CDS should be centrally cleared.
2. Single Name CDS are 'very shallow and very illiquid'.
3. Single Name CDS are 'opaque'.

In this paper, we address each of these points in turn, with particular attention to points 2 and 3, and their relevance for considering how market-facing transparency for Single Name CDS (SN CDS) should be calibrated.

1. Central Clearing of CDS

In fact, CDS are largely centrally cleared.

In the EU, the EMIR clearing obligation applies to the two most heavily traded *index* CDS contracts:

id	Type	Sub-type	Geographical zone	Reference Index	Settlement Currency	Series	Tenor
B.1.1	Index CDS	Untranched index	Europe	iTraxx Europe Main	Euro	17 onwards	5 year
B.1.2	Index CDS	Untranched index	Europe	iTraxx Europe Crossover	Euro	17 onwards	5 year

Index CDS – the most liquid part of the CDS market – are CDS referring to a broad basket of debt issuers. They allow market participants to either hedge or obtain risk exposure to a broad market segment (as opposed to SN CDS, in which the counterparties buy or sell protection against risk of default by a single debt issuer).

It is the fundamental liquidity of index CDS which makes them appropriate for a clearing mandate – these highly standardised contracts are frequently traded.

SN CDS, however, are not subject to a clearing mandate in any major derivatives trading jurisdiction because of the episodic liquidity associated with these instruments.

According to ISDA SwapsInfo, which uses data from the DTCC Swap Data Repository (SDR), 83.7% of total credit derivatives traded notional required to be reported under CFTC reporting rules was cleared in 2022. CFTC reporting rules cover any index CDS trade involving a US counterparty. DTCC SDR data shows that 58.7% of corporate SN CDS (reported under SEC rules) was cleared (voluntarily) in the week ending 24 March 2023.

When looking at application of the EMIR clearing obligation to different OTC derivatives asset classes, ESMA is required to assess derivatives contracts according to the following criteria:

- the degree of standardisation of the contractual terms and operational processes of the relevant class of OTC derivatives
- the volume and liquidity of the relevant class of OTC derivatives
- the availability of fair, reliable and generally accepted pricing information in the relevant class of OTC derivatives.

ESMA reflected on application of the clearing obligation to CDS (both SN and index) in 2014-2015, by reference to these criteria, but found that – while it would be appropriate to apply the clearing obligation to index CDS - analysis of SN CDS showed that (while sufficient standardisation was apparent, and pricing information (even in 2014) was available) there was insignificant liquidity (in particular) in that market to justify a clearing mandate.

Index CDS are largely centrally cleared, by regulatory mandate. Even though it has not been deemed appropriate to apply a clearing mandate to SN CDS, a significant share of overall SN CDS volume (and often a majority of volume) is cleared voluntarily.

2. Single Name CDS are 'very shallow and very illiquid' – and what this means for MIFIR transparency requirements

This statement is correct. SN CDS are traded infrequently, with few contracts trading more often than 10 times a day on average.

Of course, if there is increasing concern about the creditworthiness of a specific debt issuer, either for reasons specific to the issuer, or because of concerns about the market sector in which that firm operates, the frequency and volume of trading regarding specific CDS referring to a specific issuer (or set of issuers facing similar challenges) can (temporarily) increase.

Examination of DTCC Trade Information Warehouse (a repository holding *global* credit derivatives data) data illustrates this point, with heightened fears about creditworthiness (for a variety of reasons, not least among them higher interest rates) driving increased interest in taking positions in SN CDS in recent months.

Number of CDS referencing a single bond issuer (Single Name CDS) traded on average at least 10 times per day, Q1 '22 – Q1 '23 inclusive:

Time period	Total SN CDS traded >10 times per day	Non-sovereign SN CDS traded > 10 times per day
Q1 2022	22	7
Q2 2022	25	11
Q3 2022	29	16
Q4 2022	23	11
Q1 2023	72	55

As mentioned, the lack of liquidity *generally* associated with single name CDS is a key reason that they are not subject to a clearing mandate.

The episodic nature of trading in single name CDS is also the reason that near real time MIFID/MIFIR transparency does not apply to single name CDS at present.

MIFIR applies near real time market transparency to non-equity financial instruments (such as derivatives) that are liquid, while deferrals are applied for non-equity instruments that are illiquid. Market-facing (post-trade) transparency on liquid instruments provides useful, indicative (price) data to investors. MIFIR acknowledges that near real time transparency in illiquid financial instruments is inappropriate, disincentivizing liquidity providers from making liquidity available in anything but the smallest trade sizes, for fear that their own risk positions would be exposed, making it difficult and/or costly for them to make liquidity available.

The starting point for defining 'liquid market' in MIFIR for the purposes of pre- and post-trade transparency applying to derivatives business is the presence of 'ready and willing buyers and sellers on a continuous basis'. Clearly, a market like SN CDS, where a limited number (less than 10% of all reference entities, globally) of contracts trade more than 10 times per day on average does not meet this criterion. When finalizing RTS 2 (covering transparency in non-equity instruments) in 2015, ESMA elaborated this definition, setting this threshold - an average of 10 trades per day - above which single name CDS would be deemed liquid.

ISDA believes that policymakers – in reflecting on the impact on liquidity of miscalibrated transparency – should not only consider the impact on the (already) low liquidity of the derivatives market concerned, but also the impact on the underlying market. Market participants use single name CDS for a variety of reasons. These include: protecting themselves against the danger of default of their bond counterparty; hedging the marked-to-market value of bonds they have invested in, at times of, or in the event of, market stress affecting the issuer in question; hedging Credit Valuation Adjustment (CVA) risk (use of CDS for this purpose is recognized under capital rules), including through proxy hedging (hedging risks that are correlated with the risk of default of a specific bond issuer, even if the protection buyer does not hold the debt of the issuer in question). Similarly, sellers of protection may hold a positive view of the creditworthiness of a specific issuer and may want to take a long position accordingly. Market makers (or liquidity providers), meanwhile, facilitate the taking of long or short positions via CDS, as preferred by various clients (for this variety of reasons).

If liquidity in Single Name CDS is further reduced by miscalibrated market transparency, the efficiency of the underlying debt market – and hence the ability of issuers to borrow from the markets – may be affected. In credit, as in other markets, derivatives act as a pressure valve when the underlying market comes under stress. We believe that in the absence of a functioning derivatives market, the stress experienced in the underlying market may be more severe.

3. **Are SN CDS 'opaque'?**

EU regulators benefit from a number of sources of transparency regarding SN CDS, including:

MIFIR transaction reports: MIFIR requires 'complete and accurate details of such transactions to the competent authority as quickly as possible, and no later than the close of the following working day**.'** This reporting requirement – focused on supporting NCAs' mission to police market abuse and insider trading - is maintained in both the Council and EP texts of the MIFIR as currently being revised.

EMIR reporting requirements: EMIR (and EMIR Refit, effective from April 2024) also requires reporting of derivatives to trade repositories by no later than the close of the day following the execution of the trade. Data reported to trade repositories is available to regulators for monitoring for development of systemic risk.

MIFIR public transparency: As mentioned, market-facing trade transparency as currently applying to SN CDS under MIFIR is subject to deferral either in weekly aggregation[4] or volume omission[5], because of the illiquidity of SN CDS.
The Council General Approach on MIFIR applies trade transparency to i) contracts subject to the clearing obligation ii) denominated in €, $, £, ¥ iii) in certain liquid whole year tenors iv) that are actually cleared. Under this approach, SN CDS trades would not be reported to the market unless a clearing mandate applies to them. As mentioned, however, the appropriateness of a clearing mandate depends on adequate liquidity manifesting in trading of SN CDS to support such a mandate.

The above only addresses regulatory transparency, however. Commercial data service providers that also provide price information for market participants (including aggregated / composite pricing, runs, Request for Quotes, End of Day notional volumes and trade counts, etc.) include S&P Global, ICE, Bloomberg, Tradeweb and others.

4. The US regulatory framework for reporting of SN CDS

SN CDS (as Security-Based Swaps) are subject to the SEC reporting rules (under 'Regulation SBSR[6]').

Under these rules, reporting counterparties must report primary trade information and secondary trade information to a Swap Data Repository (SDR). SDRs would be required to disseminate primary trade information (e.g. product ID, date and time of execution, price, notional amounts, currencies etc.) while secondary trade information (e.g. counterparty ID or execution agent ID, terms of fixed or floating rate payments or customized or non-standard payment streams to the extent not included in publicly disseminated information, name of clearing agency (if cleared), description of settlement terms (cash/physical e.g.) would be reported to the SEC.

SBSR sets out a reporting hierarchy addressing which counterparties are responsible for reporting in different counterparty pair types.

Under the SEC rule as first adopted, reporting counterparties had 24 hours after execution of all single name CDS to report these trades to SDRs. Primary (publicly disseminated) information would be published by SDRs 'immediately upon receipt.' The reporting

[4] Weekly aggregation involves aggregation of trades from the previous week at the level of an instrument and disseminated publicly on Tuesday morning. Alternatively, the reporting is deferred on a non-aggregated basis, involving public dissemination on a trade-by-trade basis, after 4 weeks.
[5] Volume omission involves, on a trade-by-trade basis, prices disseminated publicly after 2 days and volume disseminated after 4 weeks.
[6] eCFR :: 17 CFR Part 242 - Regulation SBSR—Regulatory Reporting and Public Dissemination of Security-Based Swap Information

obligation for SN CDS cleared transactions and transactions on-venue that are intended to be cleared would fall on clearing houses and trading venues, respectively.

This 24-hour timeframe for reporting SN CDS (among other security-based swaps) was a holding measure, with the SEC indicating that it would further calibrate this reporting rule in due course, in particular with regard to the reporting timeframes and block thresholds.

The SEC then also provided No Action Relief (NAR)[7] in December 2019 that allowed firms to report SN CDS and other security-based swaps using certain components of the CFTC's reporting requirements for swaps until 2025. This NAR was universally adopted by the industry, including the DTCC as the data repository, as it simplified implementation of security-based swaps from a technical perspective.

However, less than a month before the implementation date of the SEC reporting rule, the SEC published an FAQ[8] that stated that security-based swaps dealers must also abide by the publication timelines in the CFTC's regime. As such, this required close-to-real-time reporting for the majority of SN CDS. The SEC also set a single block and volume cap threshold (above which actual volume of trades concerned would not be published) of $5 million.

This $5 million block and volume cap threshold was not set based on any analysis of the SN CDS market, but rather by reference to the block trade threshold set out in the FINRA TRACE regime for corporate bonds.

The block and volume cap levels in the CFTC rules applying to swaps other than SN CDS (including broad-based index CDS) – which market participants had expected to be applied to SN CDS prior to the publication of the FAQ mentioned above – are set at 50th percentile and 67th percentile respectively, although these thresholds will rise to 67th percentile and 75th percentile in November 2023.

We believe that the SEC rules, and aspects of the CFTC rules (to the extent they currently apply in practice to SN CDS) are miscalibrated for the purposes of the level of liquidity apparent in SN CDS business, and we would make the following remarks in this regard:

- As inferred above, no evidential basis is apparent for the calibration of the SEC's block threshold for SN CDS of $5 million.
- The level of liquidity apparent in SN CDS markets (whether dissected on a global or European basis) means that real time transparency is not appropriate for these (typically) thinly traded products. Few of these contracts meet the ESMA definition of liquidity (10 trades per day or more on average) and to the extent they meet this threshold it is *episodic* (liquidity increasing at a

[7] Available at https://www.sec.gov/rules/final/2019/34-87780.pdf

[8] SEC.gov | Frequently Asked Questions on Regulation SBSR, October 2021

moment of significant market stress, when there is a perception of a higher level of credit risk in the market, before liquidity again recedes).

- We are skeptical as to the approach taken by the CFTC to blocks thresholds and volume caps, having expected the CFTC to first address appropriate block thresholds for different asset classes in rulemaking before addressing deferral periods. It adopted its rules on each simultaneously, without (in our view) sufficient regard to the characteristics of the different swaps covered by the CFTC regime.
- However, we observe that the use of a volume cap is an important point of difference between the SEC and CFTC rules on one side, and the current MIFIR trade transparency rules on the other, where, for illiquid trades, or trades above post-trade 'Size Specific To An Instrument' (SSTI), (or Large-in-scale (LIS) for venue trades) the volume of the trade would always be published after a period of deferral. SN CDS that are 'volume capped' under the SEC regime do not ever have their full volume published, which is an important mitigant of the 'undue risk' faced by SN CDS liquidity providers in enabling client hedging at size.

5. ISDA's data analysis on CDS liquidity, and 'strawman' appropriate transparency regime for SN CDS

ISDA supports application of transparency to SN CDS business, but this transparency should be calibrated according to the liquidity characteristics of SN CDS, to ensure that liquidity providers can continue to make liquidity available to market participants seeking to hedge, on an efficient and risk-sensitive basis.

In Q3 2022, ISDA shared analysis of global CDS data with policymakers, as a contribution to ongoing deliberations on appropriate 'public' transparency requirements for derivatives business and – in this instance – credit derivatives specifically.

While this data exercise and the conclusions drawn from it outlined the shape of an appropriate 'public' transparency regime for CDS, we believe it also underlined (more broadly) the need to ensure sufficient flexibility in any MIFIR transparency regime to address the specific liquidity characteristics of different derivatives asset classes. The existing MIFIR transparency regime is at times overly granular (for example, the use of ISINs as implemented for MIFIR in the interest rate derivatives asset class generating vast number of ISINs) and at other, insufficiently granular (e.g., the entire (heterogenous) equity derivatives asset class being deemed liquid by ESMA).

ISDA's analysis used DTCC Trade Information Warehouse (TIW) data on global CDS activity for 2021.

As no transaction level data was available in this dataset, ISDA used Average Daily Volume (ADV) and Average Trade Size as criteria for assessing appropriate thresholds for assessing CDS products as liquid.

The analysis covered both index CDS and SN CDS, but in this paper we will focus on the proposals included for SN CDS transparency and deferrals.

Our analysis split SN CDS into two liquidity buckets (liquid and illiquid) and concluded that SN CDS manifesting an average daily volume of trading of $3 million or more could appropriately be labeled as liquid for the purpose of public transparency requirements.

ADV Categories	Total Traded Notional (US$ billions)	Total Transaction Count	ADV (US$ millions)	Average Daily Trade Count	Average Trade Size (US$ millions)	Trade out Period (Average Trade Size/ADV)	Number of Issuers
ADV < $3M	81.4	23,088	0.8	0.2	3.5	4.299	397
ADV ≥ $3M	1,908.9	347,819	17.0	3.1	5.5	0.322	448
Total	1,990.3	370,907	9.4	1.8	5.4	0.570	845

ADV Categories	Total Traded Notional	Total Transaction Count	Number of Issuers
ADV < $3M	4.1%	6.2%	47.0%
ADV ≥ $3M	95.9%	93.8%	53.0%
Total	100.0%	100.0%	100.0%

ISDA also looked at SN CDS applying ADV thresholds of $1 million and $5 million, but concluded (also with ESMA's historical 'coverage ratio' approach in mind) that $3 million was most appropriate for Single Name CDS, given consideration of

- Number of bond issuers covered
- Percentage of traded notional captured
- Percentage of trades captured
- Appropriate deferral periods

Analysis of 2021 TIW data showed that 95.9% of traded notional, 93.8% of all transactions and 53% of reference entities (bond issuers) in SN CDS would be covered by this (ADV of $3 million or over) 'liquid' designation and subject to the highest level of transparency in the framework.

The outcome of analysis of the coverage resulting from a $1 million or $5 million threshold is below.

ADV Categories	Total Traded Notional (US$ billions)	Total Transaction Count	ADV (US$ millions)	Average Daily Trade Count	Average Trade Size (US$ millions)	Trade out Period (Average Trade Size/ADV)	Number of Issuers
ADV < $1M	20.7	5,456	0.3	0.1	3.8	12.188	266
ADV ≥ $1M	1,969.5	365,451	13.6	2.5	5.4	0.396	579
Total	1,990.3	370,907	9.4	1.8	5.4	0.570	845

ADV Categories	Total Traded Notional	Total Transaction Count	Number of Issuers
ADV < $1M	1.0%	1.5%	31.5%
ADV ≥ $1M	99.0%	98.5%	68.5%
Total	100.0%	100.0%	100.0%

ADV Categories	Total Traded Notional (US$ billions)	Total Transaction Count	ADV (US$ millions)	Average Daily Trade Count	Average Trade Size (US$ millions)	Trade out Period (Average Trade Size/ADV)	Number of Issuers
ADV < $5M	169.0	47,896	1.4	0.4	3.5	2.542	487
ADV ≥ $5M	1,821.3	323,011	20.3	3.6	5.6	0.277	358
Total	1,990.3	370,907	9.4	1.8	5.4	0.570	845

ADV Categories	Total Traded Notional	Total Transaction Count	Number of Issuers
ADV < $5M	8.5%	12.9%	57.6%
ADV ≥ $5M	91.5%	87.1%	42.4%
Total	100.0%	100.0%	100.0%

ISDA also used this analysis to set out an appropriate deferrals regime for SN CDS, as well as – in certain cases – a volume cap (see right hand side of 'size deferral' columns below).

Category	Description	Price Deferral	Size Deferral

Category 1	5Y single-name CDS with ADV more than $3 million	1 day	1 day for transactions with notional below $3 million. 1 week for transactions with notional above $3 million and below $50 million.	Transactions w/notional < $3 million are reported with an actual transaction size in one day. Transactions w/notional > $3 million and above reported as "$3 million +". Actual notional reported in 1 week. Transactions w/ notional $50 million and above are reported as "50 million+" in 1 week and actual notional is never disclosed.
Category 2	Non-5Y single-name CDS with ADV more than $3 million	1 week	1 week for trades below $3 million 2 weeks for trades above $3 million and below $50 million	Transactions w/ notional <$3 million are reported with an actual transaction size in one week. Transactions w/ notional >$3 million and above are initially reported as "$3 million +". Actual notional is reported in 2 weeks. Transactions w/ a notional $50 million and above are reported as "50 million+" in 2 weeks and actual notional is never disclosed.
Category 3	5Y single-name CDS with ADV less than $3 million	1 week	1 week for trades below $3 million 4 weeks for trades above $3 million and below $50 million	Transactions w/ notional <$3 million are reported with an actual transaction size in one week. Transactions w/notional >$3 million and above are initially reported as "$3 million +". Actual notional is reported in 4 weeks. Transactions w/ notional >$50 million and above are reported as "50 million+" in 4 weeks and actual notional is never disclosed.
Category 4	Non-5Y single-name CDS with ADV less than $3 million	4 weeks	4 weeks for all trades below $50 million	All transactions w/notional <$50 million are reported with an actual transaction size in 4 weeks.

				Transactions w/notional >$50 million and above are reported as "50 million+" in 4 weeks and actual notional is never disclosed.

This deferrals regime (including at its heart a 1 day deferral for 5 year SN CDS with an ADV equal to or more than $3 million (as 'liquid')) was devised with regard to what the data was telling us as to how long it would take a liquidity provider in the SN CDS market to 'trade out' of positions taken when facilitating client trades.

The overriding principle here is that post trade transparency can be most helpful to markets and participants where the market is characterized by "*informational intermediation*", i.e. there are market participants with opposed market views at the same time, as opposed to "*risk intermediation*", i.e. investors with opposed views are not present at a given time and so an intermediary needs to be found who is willing to assume risk and hold it until the opposite interest materializes. In order to encourage these risk intermediaries they need to expect to be able to exit their position without loss.

If the market finds out about their trade before they have been able to exit it, there is a danger that some market participants will use this information to take market positions at the liquidity provider's expense. This will ultimately discourage liquidity provision, or at least see this extra risk factored into the price of the original client-facing trade.

As such, we believe regulators should consider how long it will take for a liquidity provider to 'trade out' of a position of significant size assumed from a client in a SN CDS trade. The expected trade out period is our best estimate of that. This is not the point at which risk has actually been exited, rather it is the average of the time it should be expected to take. Even at this time period, half of all risk will not have been exited since it is an average.

General principles in the deferrals regime set out above are:

- Deferral duration is more significant the less liquid a trade is, and the larger a trade is.
- In practice, even under this draft regime, there will be trades where liquidity providers would not, in practice, be able to trade out of the risk position before the end of those deferral periods. Liquidity in derivatives – particularly in single name CDS – is episodic. 3.1 trades per day (see the average daily trade count column entry for ADV ≥ $3 million for in the first box graph in this section on page 10) does not, in reality, or instinctively, represent a very liquid market that it will be easy to hedge exposure in. Significant risk retention/warehousing would be unavoidable, even with this proposal.
- Liquidity providers are systemic institutions, who run their businesses most effectively and most soundly when they limit directional risk exposure and make money on the spread between offsetting client positions. There are also negative

capital implications (aligning with greater risk levels) when balance sheet exposure is retained for longer periods than desirable.

Deferral periods for non-5 year SN CDS would be longer than for 5 year SN CDS, as since 5 year SN CDS transactions represent approx. 50% of traded notional and ADV, and transactions with non-five-year tenor account for the remaining 50%, the 10 different tenors in the non-5-year category, have ADV of on average 1/10th of the total non-five-year ADV. As a result, the implied trade out period (and hence deferral period needed) for non-5-year transactions is about 10 times longer than needed for five-year tenor transactions:

ADV and Tenor Categories	ADV (US$ millions)	Average Daily Trade Count	Average Trade Size (US$ millions)	Trade out Period (Average Trade Size/ADV)	Trade out Period ($3M/ADV)	Trade out Period ($5M/ADV)	Trade out Period ($10M/ADV)
< $3M	0.8	0.2	3.5	4.299	3.656	6.093	12.187
5Y Tenor	0.4	0.1	3.5	8.819	7.500	12.500	25.000
Non-5Y Tenor	0.04	0.1	3.5	88.186	75.000	125.000	250.000
≥ $3M	17.0	3.1	5.5	0.322	0.176	0.293	0.587
5Y Tenor	8.5	1.9	5.5	0.644	0.352	0.587	1.173
Non-5Y Tenor	0.9	1.2	5.5	6.440	3.520	5.867	11.735

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