ISDA Safe, Efficient Markets

ISDA Comment Paper on MiFID/MiFIR (23.11.2011)

This document sets out the preliminary views of the International Swaps and Derivatives Association (ISDA) on the potential implications for OTC derivative markets of the European Commission's review of the Markets in Financial Instruments Directive (MiFID).

The overarching objective of the original MiFID framework was to further the integration, competitiveness and efficiency of European financial markets, and ISDA supports changes that build on that goal, including the introduction of an effective post-trade transparency regime for OTC derivatives.

ISDA is concerned that the rules on establishment and organisation of OTFs, in particular the restriction in using own capital to facilitate client risk management, will disincentive investment in and participation in these platforms. We support an effective transparency regime – and will strive to continue to deliver this goal – but remain wary about the impact on market capacity and pricing for clients of a pre-trade transparency regime for OTC derivatives which essentially benefits some clients to the detriment of others.

The first part of this paper provides some background to OTC derivatives markets, highlighting in particular the more occasional way OTC derivatives are transacted in comparison to other actively traded products such as equities, as well as the fact that this is categorically not a retail market.[1] The second part, from p.8 onwards, explores some of the specific issues raised by the MiFID proposals, and offers our view as to the ways in which the proposals could be usefully amended:

- **OTFs:** We advocate the removal of provisions that would prevent the operator of an OTF from executing clients' orders against his own proprietary capital.
- **Systematic Internalization:** We believe that the obligation to make firm quotes up to a certain size available to other clients of the SI could prove counterproductive to the goal of improved competition, limiting the number of clients that systematic internalisers can trade with, encouraging defensive widening of spreads, and reducing the size at which orders can be executed. This will be to the disadvantage of end users.
- **Regulatory boundaries:** We would encourage changes to introduce greater clarity as to the boundary between SIs and 'pure OTC' business.
- **Pre-Trade Transparency**: We believe the approach being proposed for non-equity markets will result in numerous waivers being required, hence we would support a more targeted solution that takes account of fundamental differences between equity and non-equity markets, rather than a blanket approach.
- **Access:** We believe that the Article 28 of MiFIR should be amended to apply to derivatives contracts subject to EMIR access obligations.

[1] Derivatives move in line with underlying markets, reflecting the retail and institutional risk appetite in those markets.

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1. Characteristics of OTC Derivatives Markets

A. Market Size and Trading Frequency

OTC derivative contracts have been in existence for more than 30 years, and the services the market has given to clients have grown tremendously in terms of product range and size. The market now consists of five primary asset classes: interest rates, credit, commodities, equities and foreign exchange. However, other forms of derivatives, such as those referring to weather, longevity and catastrophe, are also used.

As of the end of June 2011, the Bank for International Settlements estimated risk exposures and cumulative turnover in OTC derivatives.[2] They identified $20 trillion in gross obligations arising from derivatives (with the true, net exposure at $3 trillion, though even that overstates risk exposures, since collateral is posted against this risk in the majority of cases). These figures are derived from a crude and indirect measure of cumulative turnover, so-called 'notional' amounts. Notional amounts do not themselves change hands (with occasional, well-known exceptions) but instead denote hypothetical positions, for which a change in value gives rise to an obligation under the derivative.

The same BIS data estimates $708 trillion in aggregate notional amounts[3] of contracts outstanding. Even as an imperfect measure of cumulative turnover, however, this estimate is misleading. Many analysts deduct foreign exchange ($65 trillion) from the total on the grounds that foreign exchange forwards pre-date other products by decades[4]. The BIS estimate also counts as two transactions any swap between a pair of dealers that is subsequently cleared by the London Clearing House (LCH). This essentially double counts such transactions. The LCH was clearing $298 trillion as at the end of June 2011 and so the total is overstated by $149 trillion. If these adjustments are made, the cumulative turnover figure is reduced to $494 trillion.

In all, interest rate products account for approximately 90% of the marketplace. While notional amounts outstanding are very large[5], the actual risk is somewhat lower - **close-out netting[6] of gross derivatives exposures reduces OTC derivatives credit exposure to about 0.6% of the underlying notional amount. ISDA studies further estimate that about two-thirds of the remaining exposure is collateralised.**

Furthermore, the number of transactions executed in any day is low. For all interest rate products, some 5,500 trades are executed on an average day globally. CDS new trade volumes typically run to approximately 7,000 per day. Only a small group of CDS reference names are traded more than

[2] NB: Preliminary data for H2 2011 was published in November 2011 and can be found at http://www.bis.org/statistics/derstats.htm

[3] The notional amount is the basis on which payments in a derivative contract are calculated. Actual net market value of future payments, using current market conditions, referred as the mark-to-market value is the correct measure of the risk or exposure arising from the contract and, almost always, a fraction of the notional. Aggregate (gross) mark-to-market value is about $21 trillion.

[4] It is also relevant that, average maturities are very short (in the order of a few weeks), leaving less time for mark-to-market values to build up. Moreover, the major risk is the risk of failure upon physical settlement and this is addressed through the CLS mechanism.

[5] The notional amount is the basis on which payments in a derivative contract are calculated. Actual net market value of future payments, using current market conditions, referred as the mark-to-market value is a better measure of the risk embedded in the contract and, almost always, a fraction of the notional. Aggregate mark-to-market value is about $25 trillion.

[6] Close-out netting refers to a process involving termination of obligations under a contract with a defaulting party and subsequent combining of positive and negative replacement values into a single net payable or receivable. See http://www.isda.org/researchnotes/pdf/Netting-ISDAResearchNotes-1-2010.pdf

20 times a day. Over 4,000 names have traded with each name having multiples of 40 contracts each[7].

These figures are smaller than activity in futures markets, as illustrated below[8]:

5,500	**3,600**	**300,000**	**1,200**	**<50%**
OTC interest rate derivatives contracts (including swaps, caps, collars, floors and swaptions) are executed each day in over 20 currencies.	**interest rate swaps are traded each day.**	**trades of US government and Eurodollar futures contracts occur every day. Corresponding OTC volume is 2% of that amount.**	**OTC US dollar interest rate swaps are traded daily. OTC euro interest rate swaps average just 830 trades per day.**	**of all OTC interest rate swap trades per day are standardised. The most liquid standardised swap trades about 200 times per day.**
$100m	**6,700**	**13**	**99%**	**5**
is the average size of a ten-year OTC US dollar interest rate swap. Comparable transactions in futures and securities markets are substantially smaller.	**OTC credit default swaps trade daily. Of these, 4,000 are single-name reference entities and 1,800 are credit indices.**	**out of 3,000 CDS single-names trade 20 or more contracts per day.[9]**	**of single-name CDS contracts trade less than 20 contracts per day.**	**CDS indices make up 60% of the total daily CDS index trading volume**

The key issue to note here is that regulation of OTC derivatives markets cannot simply replicate the rules applied in equity and futures markets. In particular, regulation needs to take as a starting point the fact that OTC derivatives markets are not retail markets and the fact that trading is infrequent.

B. Bilateral Execution / Counterparty Credit Risk

Derivatives are generally traded on a bilateral basis, i.e. between two counterparties. Most derivatives are executed between a bank dealer and its clients or between two dealers who seek to hedge risks they need to manage or as a means of taking on new risk. In all, there are 14 very large global dealers and another 20 or so financial institutions active in certain major markets. An exception to the bank dealer market is the commodity derivatives market where non-bank dealers are quite common. Dealers in the OTC derivatives markets act as principals, i.e. assume the market and credit risks associated with the trade until its maturity.

OTC derivatives contracts are typically multi-year contracts and involve assumption of credit risk as market rates move.

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[7] Volumes fluctuate significantly over time. There were 21,690 new credit derivative trades (13,951 Single Name and 7,739 Index and Index Tranches) executed the week ending on March11, 2011. There was an increase of 19,438 trades in TriOptima's repository during the week ended on 25 February 2011. It is estimated that this increase represents approximately 80% of all trades in rate products completed, globally, in the period. Information on trading volumes for credit derivatives, rate derivatives, bonds and futures can be obtained from the DTCC (http://www.dtcc.com/products/derivserv/data_table_iv.php), TriOptima (http://www.trioptima.com/repository), FINRA (http://cxa.marketwatch.com/finra/BondCenter/Default.aspx) and the CME (http://www.cmegroup.com) respectively.

[8] See http://www.isda.org/uploadfiles/_docs/ISDA_Brochure_2011.pdf

[9] Across all maturities, i.e. figure by maturity is lower still

Example: Interest rate swap

In an interest rate swap, one counterparty agrees to pay the other a fixed rate denominated in a particular currency, in return for the second party paying a floating rate (in the same currency). The absolute amount of interest payable in each case is calculated by reference to a 'notional' amount (which does *not* itself change hands and whose only purpose is to support the calculation of amounts of interest payable). If interest rates then fall, the counterparty receiving the fixed rate (and paying floating) will receive money from its counterparty over the life of the swap. If interest rates rise, it will have to pay money to its counterparty. This creates a credit relationship (since the expected payments clearly depend on the willingness and ability of the counterparty to perform). In fact, the credit relationship between any pair of counterparties will be as long as the longest derivative contract between them; and even at the start of a contract, when neither party owes more than the other, there is clearly the potential for exposure to arise in future. To streamline and standardise documentation, derivative Master Agreements have been developed, governing a large percentage of all contracts. These agreements typically contain netting provisions, enabling counterparties to offset in-the-money contracts (assets) against the liabilities created by out-of-the money contracts, thereby reducing exposure substantially. Furthermore, a majority of relationships also call for collateral to be exchanged (under a 'Credit Support Annex') between the parties to further reduce the netted exposure. These master agreements are negotiated with care to ensure each side is properly protected.

C. Clearinghouses

Certain derivatives contracts – plain vanilla interest rate contracts, certain credit indices and nearly 200 CDS single name reference entities – are eligible to be cleared by clearinghouse members. In these transactions, the parties usually present a transaction to a clearinghouse for clearing approval. If the clearinghouse accepts the transaction, the bilateral contract is novated and the clearinghouse becomes the counterparty to each side of the transaction. The clearinghouse requires both initial margin and variation margin to protect itself and its clearing members.

Clearinghouses can bring significant benefits. The default of Lehman Brothers in 2008 provides an important example. At that time, the London Clearing House was able to liquidate over 60,000 trades representing over $8 trillion of notional value. Wider use of clearinghouses for over-the-counter derivative products has the potential to improve market resilience by lowering counterparty risk and increasing transparency, hence our strong support for the European Commission's Proposal for a Regulation on OTC derivatives, central counterparties and trade repositories.[10]

We expect clearing of OTC derivatives to become the norm for counterparty risk management of OTC derivatives – at least for high volume products – in the coming years. This will complement the strong counterparty risk management techniques developed and deployed in bilateral transactions, notably netting and collateral.

[10] *Central counterparties for over-the-counter derivatives, S* G Cecchetti, *J* Gyntelberg, M Hollanders, BIS Quarterly Review, September 2009, 45-58.

D. Users of Derivatives Markets: Institutions

Virtually all non-dealer business in OTC derivatives is executed by institutional users - banks, investment managers, other financial firms, corporations hedging risk, and other similarly sophisticated market participants – **this is not a retail market.**

E. Pricing Derivative Products / Transparency

Nearly all users of OTC derivatives products have relationships with multiple dealers and two or more dealers are typically put into competition for each deal. Pricing is very competitive for standard transactions for creditworthy counterparties. This competition results in very a very narrow difference (the 'spread') between the price at which a dealer will either buy from or sell to a client for the most liquid products: plain vanilla interest rate swaps, many interest rate option products, credit indices and the most liquid single name CDS. Moreover, OTC derivative users are typically very sophisticated and experienced and are fully capable of executing less competitive transactions to their benefit. In fact, end users sometimes "choose not to broadcast their transaction details to multiple participants" in order to have access to efficient and cost effective hedging.[11] Recent surveys confirm that end users, by and large, are very satisfied with the service, including pricing, they get from dealers.[12]

Illustrative of these points is the blind test sponsored by ISDA in 2010[13]. In the test, three large investment managers asked groups of three dealers for firm pricing on five interest rate swaps denominated in USD or Euro. Interest rate swaps are quoted in basis points, i.e. hundredths of a percent. The average winning quote for the 15 swaps was a mere one tenth of a basis point over the middle of the market at the time the quotes were sought.

In addition to obtaining competitive pricing on transactions, clients typically have screens from dealers, containing bid and offer indications for standard transactions. Vendors such as Bloomberg also provide composite pricing screens. A number of dealers currently have the means to permit electronic execution of transactions, primarily in interest rates swaps but also increasingly in other products. Inter-dealer brokers typically have live pricing screens, enabling dealers to execute electronically. There are also electronic platforms, such as Tradeweb, that are open to end users.[14]

F. The Markets for OTC Derivatives and for Futures Contracts

Market structures and practices evolve over time, driven by the needs of market participants. Where there is the potential for frequent trading of a financial (or commodity) asset, with a large number of buyers and sellers, one or more venues emerge to promote such trading by facilitating the execution of transactions by standardising commercial terms, developing processes to complete transactions quickly and accurately and mitigating credit and other risks. Some of these markets evolve into exchanges. Much of the trading in futures contracts and a substantial portion of the trading in equities is now done on regulated exchanges. Successful exchange-traded

[11] See the Coalition for Derivatives Users letter to the CFTC dated 8 Mach 2011
[12] ISDA End-User Survey: Interest Rate Swaps, October 2010.
[13] "Interest Rate Swap Liquidity Test" - a report sponsored by ISDA and conducted by Atrevida Partners in conjunction with market participants in November 2010.
[14] An electronic platform originally developed to facilitate bond trading. Tradeweb is owned by Thomson Reuters and 10 leading dealers.

products rely on relatively active order submission by many buyers and sellers creating high transaction flow. In short, products that are suitable for trading on multilateral markets tend to do so, those that are not tend to be traded bilaterally.

Exchange-traded markets offer no guarantee of trading liquidity as evidenced by the high percentage of new exchange-listed products that regularly fail to be actively traded. For those contracts that do become liquid, exchanges allow a broad range of trading customers (including retail customers) meeting margin requirements to transact a small number of rigidly standardised contracts in relatively small amounts. As a result of the high number of market participants and the relatively small number of standardised instruments traded and the credit of a central counterparty clearer, liquidity in exchange-traded markets is relatively **continuous** in character. However, trade size is quite small and users often need to take significant market risk - the risk that market prices will move against them - to execute large positions in smaller pieces over an extended period of time.

At the other end of the spectrum are markets such as those for OTC derivatives. Here, the number of potential buyers and sellers is relatively small, almost all of which are institutional (asset managers etc), featuring a broader array of less-standardised products. Trades are typically much larger in size and much less frequent. Liquidity levels are highly variable and depend, to a very large extent, on a dealer making prices for clients either through taking on the risk themselves or finding a buyer in the market. This, of course, is how the OTC derivatives markets started and remain today. Participants in these markets are very limited in number, almost all of them are institutions and they can obtain a variety of customised products. Trading in virtually all products is infrequent at best but the average size of trades is much larger than the size in the exchange-traded markets. Indeed, users often turn to the OTC markets because they cannot execute large enough size in the exchange-traded markets in one trade.

The table below summarises the main differences between the futures markets and the OTC derivatives markets.[15]

Characteristic	**OTC Swaps (bilateral)**	**Listed Futures (exchange traded)**
Trading Counterparties	< 1000	>> 100,000
Retail Participation	None	Significant
Daily Trades	< 20,000	> 1,000,000
Tradable Instruments	>> 100,000	< 1,000
Trade Size	Very Large	Small

Despite these distinctions, it is important to appreciate that OTC markets and listed futures support and enhance one another. For example, OTC markets allow for the customization of contracts to match particular risks, while efficient listed markets are beneficial to OTC markets for hedging purposes. A similar situation is apparent in equity markets: a client might choose to place a block OTC order with a broker, who sources that order via an exchange or multiple exchanges.

[15] See *Block Trade Reporting for Over-the-Counter Derivatives Markets*. ISDA/SIFMA 18 January 2011.

Example: Hedging

Take the following example: if a risk manager needs to hedge a large position in a limited time period (which is typically the case), it might not be possible to do so by sourcing contracts via exchanges. Firstly, because the structure he seeks might not be the highly standardised one traded there and, secondly, because the small tickets traded (if any) would not allow the risk manger to close his position in the required time-frame. For these reasons, an OTC transaction would be necessary in this instance.

2. The Markets in Financial Instruments Directive and Regulation (MiFID and MiFIR)

On 20 October 2011, the European Commission published legislative proposals relating to its review of the Markets in Financial Instruments Directive. The draft framework comprises a Regulation (MiFIR) and a revised Directive (MiFID).

Below we offer a preliminary view of some of the most important issues affecting OTC derivatives markets.

A. Trading obligation

In line with the September 2009 G20 commitment that, where appropriate, standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, MiFIR introduces an obligation to trade clearing eligible and sufficiently liquid derivatives contracts on an OTF, MTF or regulated market. What is classed as 'sufficiently liquid' will be defined by ESMA in light of average frequency of trades, the average size of trades, and the number and type of active market participants.

We are supportive of efforts to increase transparency in OTC derivatives markets, hence our support for effective post-trade transparency rules, as discussed later. However, **to the extent that the trading obligation is intended to increase transparency, we believe that far greater benefit will be derived from post-trade reporting to trade repositories and to the market** than from the trading obligation.

Indeed, **only a limited number of OTC derivatives contracts will be sufficiently liquid for trading on an organised platform**, a reflection of the degree of customisation of and limited participation in OTC derivatives markets. For the same reasons, we also believe that MiFIR should acknowledge the risks associated with applying the trading obligation to inappropriate contracts, to ensure that only suitable contracts are caught.

We support the fact that the trading obligation does not apply to transactions that are not in fact cleared due to an exemption from the clearing obligation under EMIR. This will help ensure that the needs of end users are suitably accommodated.

B. Organised trading venues

ISDA strongly supports the existing flexibility and choice provided by MiFID, which has encouraged competition and driven trading costs down, and wants to avoid a situation whereby the introduction of the OTF regime compromises this choice. Indeed, given the trading obligation described above, it will be vital that there is a suitable range of venues on which to execute OTC derivatives transactions, including voice-brokered facilities. OTFs should not necessarily have to conform to a central limit order book model.

We believe that the proposed ban on an OTF operator executing client orders against his own proprietary capital will have the impact of restricting the range of available venues for trading in OTC derivatives subject to the trading obligation, notably limiting the role played by single dealer

platforms (SDPs). While there may be scope under MiFIR for SDPs to operate under the SI rules, this would mean they would be ineligible for satisfying the trading obligation.

The Commission's approach is motivated by the desire "to ensure both the OTF operator's neutrality in relation to any transaction taking place and the duties owed to clients thus brought together cannot be compromised by the possibility to profit at their expense".

We believe that this reasoning overlooks the **vital role that investment firms' risk capital plays in facilitating client business**, particularly for OTC derivatives, given the infrequency of trading, relatively small number of market participants, and degree of customisation, as highlighted earlier in this paper. Associated investment firm hedging of client business inevitably occurs over an extended period of time.[16]

We are also concerned that it is envisaged that "*an OTF shall not connect with another OTF in a way which enables orders in different OTFs to interact*". While we understand this stems from the concern that connected OTFs would resemble an MTF (and thus should be regulated as such), we believe an operator of an OTF should be able to route an order to another OTF where this is in the best interests of the client. We therefore seek clarity as to whether this prohibition is intended to cover operators of OTFs.

Continuing on the theme of client interest, we believe there are many regulatory requirements that would effectively ensure that clients' interests are not damaged by the activities of an OTF operator, such as best execution and OTF-tailored rules on conflicts of interest management and order handling; we would strongly support these over a restriction on use of proprietary capital by OTF operators.

Returning to some of the points raised earlier in the paper, the reasons for preserving diversity in terms of how and where trades can be executed is clear:

- Organised markets are not necessarily more efficient than OTC ones – note the large number of futures contracts that fail (only 10% of agricultural contracts survive 10 years)[17].
- IOSCO has highlighted that adopting a flexible approach to what constitutes a trading platform is the best way to deliver on the G20 commitment to platform trading of standardised derivatives.[18]
- OTC markets typically have up to 1000 participants vs. 100,000+ in listed futures markets.
- OTC derivatives markets do not cater to retail clients: the average CDS trade is about $5 million for single names and is geared to large investors.
- Central clearing is arguably the more significant development when it comes to reduction of systemic risk. The interest rate derivatives market has been cleared for over ten years

[16] http://isda.derivativiews.org/2011/10/07/the-new-york-fed-report-part-ii-hedging-and-market-making/

[17] B. Wade Brorsen and N'Zue F. Fofana, 'Success and Failure of Agricultural Futures Contracts', in *Journal of Agribusiness* 19,2, online at http://www.jab.uga.edu/Library/f01-03.pdf

[18] See www.iosco.org/news/pdf/IOSCONEWS196.pdf

with SwapClear currently having over 1.49 million contracts cleared. CCPs also have an established role in energy markets.

- It should be noted that the OTC derivatives industry has gone even further, introducing the technique of compression (which can be applied to an even wider range of contracts than clearing).[19]

As explained in the opening section of this paper, OTC and listed derivatives markets are complementary in nature, and aggressive convergence on a purely multilateral execution model would not necessarily make for a safer market place.

We also highlight the need to ensure that the **boundary between different categories of venue is clear**, most notably as concerns the boundary between SIs and 'pure OTC' business, the latter being limited to transactions that occur on an occasional, ad hoc and irregular basis.

Similarly, it should be made clear that the SI classification applies by class or sub-class of financial instrument, not at the level of legal entity – a firm might be an SI for one or more instrument, but that should not mean that it must act as an SI for all instruments that it trades.

And finally, we would encourage policymakers to consider carefully the intended scope of the OTF regime – as currently drafted it may unintentionally capture activities such as securities lending which could be seen as the matching of buying and selling interests.

Ensuring clear delineation of these different regulatory concepts will be key to ensuring that the OTC derivatives market continues to function smoothly. In this regard, we would welcome explicit confirmation in the text that the OTF category will encompass voice and hybrid execution models.

C. Pre- and post-trade transparency in non-equity markets

The issue of trading venues is closely linked with that of transparency. Considering first pre-trade transparency, we note the power for competent authorities to waive pre-trade transparency obligations that would otherwise apply to OTC derivatives. Given the nature of activity in OTC derivatives markets, it is likely that such waivers will have to be broadly applied in order to maintain anonymity and hence liquidity in these markets. This issue is illustrated by CDS statistics showing the infrequency of trading:

- About 6,700 trades per day
- Only 13 single names trade more than 20 times per day
- 99% of single names trade less than 20 times per day

Also note the competitiveness of the market as mentioned earlier: ISDA sponsored a blind test in 2010 in which three large investment managers asked groups of three dealers for firm pricing on five interest rate swaps. The average winning quote for the 15 swaps was just one tenth of a basis point over the middle of the market at the time the quotes were sought.

[19] $75bn of CDS contracts have been torn-up as part of this process.

Given the likely need for a large number of waivers, we would support a more targeted solution to pre-trade transparency for non-equity markets, rather than a blanket approach. Inappropriate pre-trade transparency obligations could ultimately raise costs for end users of the market. Furthermore, we support measures in the text to ensure that waivers are applied consistently across member states and in a timely manner – the proposal that ESMA should have 6 months to consider a proposed waiver is too long.

Specifically on the SI regime, we believe that the obligation to make firm quotes up to a certain size available to other clients of the SI could prove counterproductive to the goal of improved competition. It could in effect limit the number of clients that systematic internalisers can trade with, and could also encourage defensive widening of spreads, as well as a decline in amounts offered. This would result in poorer execution for the end user. At the same time, provisions for an SI to define in its commercial policy the limits on the number of transactions it will enter into are currently too vague.

Furthermore, there is a disparity between the SI regime as envisaged for equities and that envisaged for OTC derivatives – for equities, there is an explicit exemption from the obligation to publish firm quotes for trades that exceed normal market size. While the intention seems to be equivalent for OTC derivatives, this should be made explicit. That said, we also note that OTC derivatives trades are by nature very large – it would be misleading to assume that there is a meaningful distinction between 'retail' and 'wholesale' transactions.

As for post-trade transparency, we support the development of a formal regulatory regime for OTC derivatives, as long as it is sensitive to the nature of the market, with reporting delays and volume masking based on transaction size. This should reflect the operation of the market and give market participants enough time to manage their positions over time. As such, careful consideration of the appropriate reporting delay for different size trades and different assets classes will help ensure that the impact on the cost of hedging is not such as to discourage provision of liquidity to end users. It will also need to allow for adjustments during periods of market stress.

We are broadly supportive of the 2010 CESR (now ESMA) advice on this issue, which covered credit derivatives.[20]

We also highlight our full support for to transparency to regulators – to this end ISDA has been closely involved in work to establish trade repositories for reporting of derivative trades.

D. Access to CCPs

We **welcome efforts to ensure that there is robust competition between trading venues and between providers of post-trade market infrastructure**. We therefore support the requirement that CCPs provide non-discriminatory clearing access for financial instruments regardless of execution venue. We specifically welcome the fact that this covers access to the associated margin pool within the CCP.

[20] http://www.esma.europa.eu/popup2.php?id=7005

We do, however, note that the wording of Article 28 of MiFIR differs from similar provisions under Article 8 of EMIR, which could lead to an uneven playing field between instruments subject to EMIR and those not. We believe that there should not be a difference in the Level 1 provisions on access under EMIR and MiFID. For this reason, we would suggest that Article 28 of MiFIR be amended such that it also applies to derivative contracts subject to EMIR access obligations. Level 2 measures should also support this goal.

3. Conclusions

ISDA believes that the following adjustments to the European Commission proposal should be considered:

- **OTFs:** We advocate the removal of provisions that would prevent the operator of an OTF from executing clients' orders against his own proprietary capital.
- **Systematic Internalization:** We believe that the obligation to make firm quotes up to a certain size available to other clients of the SI could prove counterproductive to the goal of improved competition, limiting the number of clients that systematic internalisers can trade with, encouraging defensive widening of spreads, and reducing the size at which orders can be executed. This will be to the disadvantage of end users.
- **Regulatory boundaries:** We would encourage changes to introduce greater clarity as to the boundary between SIs and 'pure OTC' business.
- **Pre-Trade Transparency**: We believe the approach being proposed for non-equity markets will result in numerous waivers being required, hence we would support a more targeted solution that takes account of fundamental differences between equity and non-equity markets, rather than a blanket approach.
- **Access:** We believe that the Article 28 of MiFIR should be amended to apply to derivatives contracts subject to EMIR access obligations.

For queries, please contact Adam Jacobs (ajacobs@isda.org)

About ISDA

Since its founding in 1985, ISDA has worked to make OTC derivatives markets safe and efficient.

ISDA's pioneering work in developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions, has helped to significantly reduce credit and legal risk. The Association has been a leader in promoting sound risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool.

Today, the Association has more than 800 members from 55 countries on six continents. These members include most of the world's major 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 derivatives to efficiently manage the financial market risks inherent in their core economic activities.

ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – show the strong commitment of the Association toward its primary goals; to build robust, stable financial markets and a strong financial regulatory framework.

Further reading

Swap execution facilities: Can they improve the structure of OTC derivatives markets?, ISDA
www.isda.org/media/press/2011/pdf/SEF-FinalVersion.pdf

Block Trade Reporting for Over-the-Counter Derivatives Markets, ISDA/SIFMA, 18 January 2011
www.isda.org/speeches/pdf/Block-Trade-Reporting.pdf

MiFID Consultation – ISDA Response, January 2011
www.isda.org/speeches/pdf/MiFID-ISDA-Response.pdf

Joint AFME/ISDA/BBA/ICMA response to CESR Technical Advice to the European Commission in the context of the MiFID Review: Client Categorisation
http://www.afme.eu/AFME/Policy_and_Advocacy/AFMEISDAICMABBAResponsetoCESRreClientCategorisation4August2010final.pdf

Joint AFME/BBA/ISDA response to CESR Technical Advice to the European Commission in the Context of the MiFID Review: Non-equity markets transparency
http://www.isda.org/c_and_a/pdf/JointResponse-CESR.pdf

ISDA Response to CESR on Consultation on guidance to report transactions on OTC derivative instruments
http://www.cesr-eu.org/popup_responses.php?id=5320

Financial Stability Board report on OTC Derivatives Market Reforms Implementation:
A response from the International Swaps and Derivatives Association (ISDA)
http://www2.isda.org/attachment/MzEyMA==/ISDA-response-to-FSB-paper_final-May%202011.pdf