



ICMA

International Capital Market Association

Update on OTC Markets Regulatory Issues

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CESR Chairman: views at European Parliament

- On 26.10.10 Carlos Tavares addressed the European Parliament's Economic and Monetary Committee (ECON)
 - “An essential reform concerns **OTC markets**, through which a good part of the ongoing crisis was disseminated”

Proposed regulatory reforms package

- The European Commission is progressing a **package of measures to reform the regulation of OTC markets, including:**
 - a cross-cutting European Market Infrastructure Regulation (**EMIR**)
 - to create a framework for OTC derivatives; and the authorisation and operation of clearing houses & trade repositories;
 - further amendments to the Capital Requirements Directives (**CRD**)
 - to create incentives for the use of centrally cleared contracts;
 - revision of the Market Abuse Directive (**MAD**)
 - to fully cover derivatives; and
 - revisions to the Markets in Financial Instruments Directive (**MiFID**)
 - to introduce other desired elements, e.g. OTC transparency requirements

European Commission's OTC derivatives proposals

- “The recent European Commission’s proposals on OTC derivatives markets point to the right direction and are indeed most welcome.
- Within these proposals, I **highlight the following**:
 - 1) post-trade transparency as provided by trade repositories,
 - which would enable supervisors to track market abuse more easily;
 - 2) mandatory clearing of standardised derivatives through central counterparties and defined by ESMA’s binding technical standards,
 - would bring more liquidity and transparency to such products;
 - 3) CCP risk management and risk mitigation measures,
 - will deliver further security”

European Market Infrastructure Regulation (“EMIR”)

- European Commission published its consultation paper “**Derivatives and Market Infrastructures**”, on 14.06.10
 - In preparation for a European Market Infrastructure Regulation (“EMIR”)
- European Commission published its EMIR proposal - “**Regulation on OTC derivatives, central counterparties and trade repositories**”, on 15.09.10
 - EMIR proposal is a Regulation (i.e. directly applicable across the EU)
 - Proposed scope of the Regulation is wide
 - Certain exemptions are explicitly foreseen
- The aim is for the new rules to be effective as of 2013

FSB – Improving OTC derivatives markets

- Financial Stability Board issued “**Implementing OTC Derivatives Market Reforms**”, on 25.10.10
 - Sets out 21 recommendations re implementation of G20 commitments on standardisation, CCP clearing, platform trading, and trade repository reporting
 - First step toward consistent implementation of G20 commitments
 - Highlights the amount of work that remains going forward
 - Working group will make regular reports on implementation progress
 - First report to be given in March 2011
- 12.11.10 Seoul Leaders’ Summit endorsed the FSB’s recommendations for implementing OTC derivatives market reforms

CPSS – Strengthening repo clearing and settlement

- Committee on Payment and Settlement Systems issued “**Strengthening repo clearing and settlement arrangements**”, on 15.09.10
 - Presents a **comprehensive survey of the clearing and settlement arrangements for repos** in selected CPSS member countries
 - **Identifies several issues** related to clearing and settlement arrangements for repos that have the potential to affect the resilience of repo markets
 - **Outlines options and measures** to address these issues

CPSS – Clearing market structure developments

- CPSS issued “**Market structure developments in the clearing industry: implications for financial stability**”, on 10.11.10
 - Provides a broad overview of the clearing industry in CPSS countries, covering both traditional markets and OTC derivatives markets
 - Particularly describes market structure developments from 2000 – 2010
 - Assesses how far these developments have given rise to new risks
 - Outlines practical issues that central banks, regulators and overseers may wish to consider
 - Examines to what extent changes in market structure or ownership might affect the expansion of central clearing services.
 - Considers effect of ownership on CCPs' incentives to manage cpty risks

International standards for CCPs

- CPSS and IOSCO published their consultation “**Guidance on the application of 2004 CPSS-IOSCO Recommendations for Central Counterparties (CCPs) to OTC derivatives CCPs**”, on 12.05.10
 - CPSS-IOSCO published the submissions received
- This work will be incorporated in their general review of international standards for financial market infrastructures
 - Launched by CPSS and IOSCO in February, for planned Q1 2011 delivery
- 12.11.10 Seoul Leaders’ Summit welcomed ongoing work by CPSS / IOSCO on CCP standards

Counterparty Credit Risk in the CRD

- The Commission services are considering a legislative proposal amending the treatment of counterparty credit risk (CCR) in the CRD
 - The purpose of such proposal would be to **strengthen the capital requirements for counterparty credit exposures arising from institutions' derivatives, repo and securities financing activities**
 - The objective of these amendments would be to
 - Raise the capital buffers backing these exposures;
 - Reduce procyclicality; and
 - Provide **additional incentives to move OTC derivative contracts to CCPs**,
 - Thus helping reduce systemic risk across the financial system
 - They would also provide incentives to strengthen the risk management of CCR

Strengthening the resilience of the banking sector

- Basel issued consultation on **capital and liquidity**, on 17.12.09
 - Parallel European Commission consultation issued 26.02.10
 - Respectively known as the “Basel 3” and “CRD IV” proposals
- Basel announced broad agreement on these reforms on 26.07.10
 - Further announcement on 12.09.10 regarding calibration and timing
- 12.11.10 Seoul Leaders’ Summit adopted these Basel proposals

Capital Requirements Directive (“CRD”)

- The European Commission is continuing its work on further possible changes to the Capital Requirements Directive (CRD)
 - A legislative proposal is scheduled for the first quarter of 2011
 - This **broadly mirrors the Basel Committee’s work** (“Basel 3”)
- European Parliament adopted the Karas report on 7 October, including
 - Greater attention must be given to the cumulative impact on banks of Basel III standards and all other regulations presently in force or under preparation;
 - Commission should produce a comprehensive assessment of the consequences of the new standards on the real economy;
 - Commission should take into account variations across the EU market in relation to corporate financing when preparing its legislative proposal; and
 - Commission should consider the definition of “capital”; and tier 1 eligibility

Review of the Market Abuse Directive

- “In a different but related field, the review of the Market Abuse Directive should **extend its principles to the OTC derivatives markets**.
 - This would be an essential tool for regulators to fight market abuse and make a clear distinction between that and legitimate speculation.
 - In the same vein, I also welcome the recent European Commission’s proposals on short selling and credit default swaps,
 - as they quite significantly strengthen the tools for efficient supervision of these market realities.”

Market Abuse Directive (“MAD”)

- European Commission published its consultation paper “**A Revision of the MAD**”, on 28.06.10
 - Commission services consider that **market integrity and investor protection would be significantly enhanced** by:
 - Extending the scope of MAD to cover instruments which are admitted and/or traded on a multilateral trading facility (MTF) but not traded on a regulated market;
 - Extending the scope of MAD so that it covers market manipulation by the use of OTC instruments that can influence the prices of a financial instrument traded on a regulated market or an MTF
(as it is already the case when trading OTC derivatives which are admitted to trading on a regulated market when in possession of inside information) ;
 - Prohibiting attempts of market manipulation
 - Adapting the definition of inside information for commodity derivatives
 - The Commission published the submissions received and will issue a proposal

European Commission – short selling proposals

- Commission launched a “**short selling**” public consultation, on 14.06.10
- Commission then issued a **draft legislative proposal** on 15.09.10
 - Proposes a two-tier transparency model
 - Persons entering into short sales of shares or sovereign debt must, at the time of the sale, have borrowed (or arranged to) the instruments ready to settle
 - Trading venues must ensure there are adequate arrangements in place for the buy-in of shares or sovereign debt where there is a failure to settle
 - Certain exemptions are provided for
 - Competent authorities have certain incremental emergency powers
 - Aim is for new rules to be effective from July 2012

The ongoing MiFID review

- “In the current circumstances the ongoing **MiFID review** is not just a regular review. It should be, in my view, a substantive reform which also incorporates the lessons from the recent past.
 - I will dare to point out what I believe could be the **seven virtuous points of a global MiFID’s review**:
 - 1) ensure the implementation of markets integrated information;
 - 2) extend the scope of transaction reporting;
 - 3) ensure that the best execution principle is implementable and enforceable;
 - 4) extend transparency obligations with due adaptations to other instruments and markets;
 - 5) regulate new modalities;
 - 6) bring, whenever possible, OTC bond & derivatives trading into organized trading venues; and

Committee of European Securities Regulators

- CESR's **Technical Advice to the European Commission in the Context of the MiFID Review** and Responses to the European Commission Request for Additional Information:
 - CESR advice papers / feedback published 29 July
 - Equity Markets
 - Non-equity Markets Transparency
 - Transaction Reporting
 - Investor Protection and Intermediaries
 - Further CESR advice papers / feedback published 13 October
 - Standardisation and Organised Platform Trading of OTC Derivatives
 - Equity Markets: Post-trade Transparency Standard
 - Client Categorisation

Markets in Financial Instruments Directive (“MiFID”)

- European Commission will publish its consultation paper “[**Revision of MiFID**]”, on [XX.11.10] (??)
 - In preparation for a legislative proposal to be issued in [April] 2011
- The aim is for the new rules to be effective as of [2013]
- European Parliament’s “Swinburne” report adopted by ECON (09.11.10)
 - Intended to influence the Commission’s thinking ahead of its own proposals being published

Adoption of legislative measures

- Market Infrastructure – proposed Regulation adopted 15.09.10
- CRD IV – proposed directive text to be adopted **Q2 2011**
- MAD – proposed directive text to be adopted **Q1 2011**
- Short Selling – proposed Regulation adopted 15.09.10
- MiFID – proposed directive text to be adopted **Q2 2011**
- Other measures also of relevance include:
 - Securities Law Directive; Settlement Regulation; Netting Directive; and ???

Thank you, Ladies and Gentlemen

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