

FESE RESPONSE

IOSCO CONSULTATION ON UNREGULATED FINANCIAL MARKETS AND PRODUCTS

1. INTRODUCTION

The Federation of European Securities Exchanges (FESE) represents the Market Operators of 42 securities exchanges active in equities, bonds, and derivatives in the European Union (EU) and Iceland, Norway and Switzerland.

FESE welcomes the opportunity to comment on the IOSCO consultation on unregulated financial markets and products and fully supports the work of the IOSCO Technical Committee on producing recommendations on regulatory approaches that may be implemented with respect to securitisation and credit default swap markets.

Below you will find our **general comments** on the paper followed by **specific comments on interim recommendations 3, 4, 5** and on potential **recommendations to apply more widely to unregulated financial markets and products**.

2. FESE RESPONSE TO THE IOSCO CONSULTATION ON UNREGULATED FINANCIAL MARKETS AND PRODUCTS

2.1. General comments

In response to your point that the primary reason for choosing these examples is because of the great significance of securitisation and CDS to credit availability in the real economy and their contribution to the management of individual and systemic risks, we consider that the reduction in credit availability, particularly unsecured lending, may not exclusively be a consequence of CDSs and the impact that they have had on the availability of credit. This is also due to the reduction in confidence and the increased counterparty risk created by the unknown losses associated with the ownership of opaque and complex structured derivatives, including CDS. In any case, when considering how to structure and regulate CDS markets, it is important to differentiate between non-standardised and standardised CDS contracts.

We concur with the statement that CDSs provide a “valuable risk transfer function” and agree that CDSs are also used for speculative purposes or trading on price. This is probably true for many derivative/structured products. However, speculation or trading on price represents an essential source of liquidity which contributes to the efficiency of the markets. As with any instrument used for the transfer of risk, there will be also participants ready to adopt that risk.

We agree that a certain level of transparency promotes efficient and well functioning markets but it does not necessarily reduce volatility or the cost of credit protection. Indeed, in some circumstances efficient markets may lead to a more realistic and increased cost of credit protection.

2.2. Specific comments on interim recommendations 3, 4 and 5.

Interim recommendation #3

TC interim recommendation #3 IOSCO recommends that jurisdictions should assess the scope of their regulatory reach and consider which enhancements to regulatory powers to support TC interim recommendation #1 and #2 in a manner promoting international coordination of regulation are needed.

As a general principle we consider that the steps referred to in interim recommendation 3 should be coordinated internationally.

Interim recommendation #4

TC interim recommendation #4: IOSCO encourages industry responses in the CDS market and recommends the following regulatory responses: 1. Provide sufficient regulatory structure for the establishment of CCPs to clear standardised CDS, including requirements to ensure: a) appropriate financial resources and risk management practices to minimise risk of CCP failure;⁸¹ b) CCPs make available transaction and market information that would inform the market and regulators; and c) cooperation with regulators; 2. Encourage financial institutions and market participants to work on standardising CDS contracts to facilitate CCP clearing. 3. CPSS-IOSCO Recommendations for CCPs should take into account issues arising from the central clearing of CDS.⁸² 4. Facilitate appropriate and timely disclosure⁸³ of CDS data relating to price, volume and open-interest by market participants, electronic trading platforms, data providers and data warehouses; 5. Establish an appropriate framework to facilitate information sharing and regulatory cooperation between IOSCO members and other supervisory bodies in relation to CDS market information and regulation; and 6. Encourage market participants' engagement in industry initiatives for operational efficiencies.⁸⁴

We strongly believe that centralised clearing through a CCP mitigates counterparty risk, increases liquidity, allows for uniform margining and risk control requirements over clearing house members, increases price transparency and provides records on CDS transactions. Where CCP clearing is not appropriate due to lacking standardisation or price information, risk management could be enhanced in any case, for example through at least bilateral netting and collateralisation of open risk positions by third-party agents, which would ensure that gross risk is reduced as far as possible and remaining open risks are collateralised and therefore insured.

While FESE members broadly encourage CCP clearing of CDSs, there are differences among FESE members' views on the degree of regulatory intervention appropriate here: Some FESE members are in favour of mandating centralised clearing through a CCP for the vast majority of CDS; while other members welcome and believe to be sufficient industry initiatives that encourage, on objective and justifiable grounds, CCP clearing of standardised CDS products. For the latter, there is a concern that forcing parties to centrally clear such products could actually encourage CDS market participants to deliberately make certain terms non-standard to avoid using a CCP.

In addition, we support initiatives to provide regulators with transaction and market data relating to CDSs as long as such information is provided on a strictly private and confidential basis (subject to the sharing of information between regulators referred to in point 5 of interim recommendation #4 above).

Interim recommendation #5

TC interim recommendation #5:

IOSCO recommends that jurisdictions should assess the scope of their regulatory reach and consider which enhancements to regulatory powers are needed to support TC interim recommendation #4 in a manner promoting international coordination of regulation.

We agree that international coordination is essential for any measures to be effective. Any measures taken should ensure the ability of CCPs to clear CDS effectively across jurisdictions.

2.3. Recommendations to apply more widely to unregulated financial markets and products.

Can we develop general recommendations to apply more widely to unregulated financial markets and products?

Standardised OTC derivative products

With a view to restoring stability and confidence in the financial markets at large, we believe that the IOSCO Technical Committee should extend the recommendations for CDSs to other OTC derivatives when they create similar systemic risk. However, we believe that the specific nature and characteristics of those products should be taken into account before any steps are taken. As noted in the consultation report, the market for unregulated interest rate products is significantly larger than that of CDSs, for this reason some members believe that the extension of the interim recommendations for CDSs to unregulated interest rate products would be a useful next step. It should be noted that the industry has already developed services to centrally clear interest rate swap products.

As stated above, we consider that international coordination is essential for any measures taken to be effective.

Non- Standardised OTC derivative products

We believe that only standardised eligible products are likely to be suitable for CCP clearing. Non-standardised products should be encouraged to become standardised to the greatest extent possible, while acknowledging that standardisation will not be possible in every case and that there continues to be a role for customised OTC derivative products for risk reduction for clients.