London, 25 June 2010

CPSS Secretariat
cpss@bis.org
IOSCO Secretariat
CCP-OTC-Recommendations@iosco.org

BY ELECTRONIC MAIL

Dear Sirs,

Re: ICAP response to CPSS-IOSCO OTC derivatives CCP

ICAP is grateful for the opportunity to respond to the CPSS-IOSCO consultation paper. As the world's premier voice and electronic interdealer broker and provider of post-trade services, the Group sits at the crossroads of wholesale financial markets. ICAP facilitates the flow of liquidity in OTC transactions between commercial and investment banks and other major financial institutions around the world. The Group is active in the wholesale markets in corporate bonds, asset-backed securities (ABS), collateralised debt obligations (CDOs), credit default swaps (CDS) as well as in interest rates, commodities, FX, emerging markets, equities and equity derivatives. On behalf of its customers, ICAP transacts on average €1.6 trillion of volume each day.

Each of the individual markets in which ICAP operates has evolved over time according to both the intrinsic nature of the instrument traded and the needs of participants operating in those markets. The breadth of ICAPs trading platforms – from purely electronic through hybrid (voice-brokered) electronic to pure voice-broking – reflect the diversity of instruments traded in international wholesale capital markets. We believe that central clearing improves the efficiency of these markets.

Each market is different and while ICAP fully understands the reasons of the current regulatory focus on the increased use of central clearing facilities, we would encourage regulators to reflect carefully on mandatory/incentivised clearing of eligible contracts. The inter-relationship between the desire to increase central clearing and adequate liquidity of the underlying contracts is crucial for the protection of the central clearing providers. A key requirement of central clearing of eligible contracts is non-discriminatory access. This applies to both bilateral/voice brokered trades as well as electronically arranged transactions. Without guarantees of access there will not be fair and open competition between trading venues and instead monopoly structures could arise for firms that operate both trading venues and CCPs.

ICAP believes only approximately 75% of market volumes will prove to be eligible for central clearing (see BCG analysis prepared for ICAP in annex A). Reiterating that liquidity will be key to eligibility of contracts for clearing, we also want to highlight that end users will continue to need tailored/illiquid derivatives to hedge specific economic risks. Although the response to this consultation is focussed exclusively on CCPs we trust that the regulatory community will also take a close interest in encouraging effective credit risk mitigation through bilateral clearing when regulated institutions adopt robust, resilient and auditable processes, different but very close to best practise of central clearing.

Our response will be limited to some specific recommendations where we feel additional attention or possible changes may be helpful in reaching the goal of a robust framework for central clearing, not only for OTC derivatives products but all eligible products for centralised clearing.

We remain at the disposal of both CPSS and IOSCO to provide additional material where this is required and look forward to discussing these matters further in the near future.

Yours sincerely,

Godfried de Vidts
Director of European Affairs, ICAP

Recommendation 1: Legal risk

ICAP fully endorses the need for a high level of transparency by the CCP in particular when the CCP retains discretion to adopt its own interpretation of legal documentation (see also our response re recommendation 13 below). A CCP could abuse its position by defining non-standard legal protocols for competitive organised trading venues that are difficult to code to or change frequently. Legal protection should not be the basis of anti-competitive barriers.

Recommendation 2: Participation requirements

The regulatory reform is focussing on increasing centrally cleared OTC derivatives. This will extend to entities that have not yet participated in centralised clearing arrangements. The monitoring tools and risk management procedures of CCP will need to be adequately changed to take into account this new type of clients. Although many buy-side clients will not be considered as direct participants and General Clearing Members (GCMs) will be used, regulation will need to pay adequate attention to these indirect users of CCP services. Careful consideration has also to be given by the rights of CCPs to refuse indirect access to their CCP services. In light of current work on customer protection in case of over collateralisation and the ability of users to change GCMs in an adequate and immediate way in case of potential default of the latter additional work is needed.

Recommendation 3: Measurement and management of credit exposures

ICAP would like to highlight the need for the broadest possible sources of data for the measurement of credit exposures. Individual trading venues will not always have a continuous flow of trades and clearing house need to use as wide as possible range of data providers as possible 3.3 re concentration of risks we refer to our response to recommendation 5 below.

Recommendation 4: Margin requirements

As highlighted in this recommendation a continual review of product correlations is highly important. Although a high number of transactions will be centrally cleared, a relatively high number of bespoke transactions may not be able to be centrally cleared as liquidity may not be available. However, trade reconciliation services provide a market consensus on all OTC derivatives from a large number of users of these products. These will have great value in providing additional information for CCPs and should be taken into considerations when models and parameters used in setting margin requirements are reviewed (ref 3.e).

Recommendation 5: Financial resources

Experience has shown that a default by a major market participant can have an adverse impact on the financial resources of a CCP. In that respect, CPSS-IOSCO should carefully look at the Committee of European Banking Supervisors (CEBS) of December 11th 2009 new guidelines on common reporting for Large Exposures and also the newly developed guidelines on the revised LE regime introduced in the EU capital adequacy directives. An exposure from a General Clearing Member (GCM) may influence adversely the financial resources from a particular CCP. However, different OTC derivatives products may be cleared by different CCPs. As a consequence inadequate global supervision on such large exposures across CCPs may be missing.

Recommendation 6: Default procedures

In reference to Paragraph 4.6.4 of the existing Recommendation 6 re CCP arrangements to facilitate transfer, close out or hedging of a defaulting participant's proprietary positions the document refers to the possible illiquidity of cleared products in times of stress while appropriate measures have to be pre-agreed with all eligible firms requesting use of central counterparty clearing services. Experience in recent years not only in the close-out of OTC derivative position but also in other products like fixed income has shown that active participation of the users of central clearing services is crucial when a major default occurs. As such pre-arrangements have to be embedded in the default procedures of any central clearing provider to be able to face illiquid market conditions in times of stress.

As a consequence (as described in 6.2) the recommendations should make sure CCPs have direct contact with the relevant OTC markets to be able to obtain individual hedges in case of default when the centralised clearing markets are unable to perform. ICAP believes that both centrally cleared and bilateral markets will continue to exist. Bespoke, more complex products will provide an alternative for hedging previously centralised cleared positions in case of extreme and volatile markets. Although not the goal the obligation for CCPs to continuously inform themselves and stress test these situations with the bilateral market (either with individual major market participants or anonymous electronic trading systems). The intelligence gathered in this way will help tackle unforeseen events that could impact the robustness of CCPs as well as bilateral markets.

Recommendation 12: Efficiency
OTC derivatives can be traded in different ways. Whereas the recommendation used the term “multiple venues” it should be recognised that the interpretation of this wording can in itself be restrictive. ICAP recommends this to be reworded into multiple trading methods as there may be trades concluded by voice either bilaterally or through interdealer brokers, electronically through MTF’s or exchanges and/or any hybrid model that may exist. A good example of efficiency gains from links to multiple venues is the example in the Italian government bond market. In early March 2009 ICAP’s electronic broking system Broker Tec launched a service as requested by the repo market community to be able to send pre-agreed Italian bilateral repo trades into the Italian CSD Monte Titoli and the relevant CCP (CC&G or LCHClearnet SA). Traders are now able to transact the pre-agreed trades away from the existing “live” market (MTS, Broker Tec) and route these trades through this electronic platform enhancing the flows of Italian repo transactions to the CCP of their choice.

Recommendation 13: Governance
In order to guarantee that CCPs adhere to reliable industry standards and market protocols the representation of active sell-side market participants in the governance structure of CCP should be mandated. CCPs should also have product advisory group (PAG) meetings where all concerned parties like dealers, buy-side and electronic trading system providers discuss market developments. This PAG is crucial for the CCP to understand market trends that may affect product evolution providing important market intelligence but also the ground for future clearing standard improvements. Such standards need to be adapted continuously to cater for market innovations. As mentioned previously, market innovations will continue to happen in the bilateral markets and only after some time central clearing of such products may be considered. As a consequence industry standards and market protocols will always be advanced and be well ahead of what can be described as “old products”. Ignoring these facts could be detrimental in two aspects; creating barriers towards an evolution towards more centralised clearing and inadequate changes in the central clearing management of products to new standards. Furthermore, as highlighted in point 13.1 consideration should be given to the interests of different market participants (including indirect participants). This reflects also our points may on recommendation 2 of this letter.

We fully agree with your comments under point 13.4 that divergent practices by CCPs and/or individual market participants (like debt management offices or nationally influenced product developments) can have a detrimental impact on the development processes to govern and reduce risk in the OTC derivatives markets. It is therefore highly important that the recommendations by CPSS/IOSCO make it clear what the structure of governance and the preferred set-up on any CCP should look like.

In that respect the proposed market governance arrangements are too narrow. In particular where CCPs are providing clearing services in the OTC derivatives market it may be appropriate of the relevant CCPs to be represented on the ISDA Credit Derivatives Determination Committee. But there is also a need to recognise that such a position may impact on the work flow linked to the service. An example could be CCPs introducing a workflow for trades originating on their own trading venue, enabling them to add a delay in the time competitive venues submit trades. CCPs would also partner with third-party vendors and introduce some exclusivity period for new workflows solutions. CCPs may connect various points of the workflow to their own systems and may prevent access to these workflow improvements for incumbents.

Recommendation 14: Transparency

In general terms we agree that more transparency as to the OTC markets may be useful. However, CCPs themselves should also be subject to more transparency. To prevent discriminatory cost practises to occur full transparency of clearing costs to assure clearing participants of a level playing field should be requested. In line with similar industry discussions, there should be a prohibition of subsidization of trading and clearing fees i.e. unbundling of services should be demanded. This would allow overview of access to clearing on the basis of equal fees and prevent volume discounts to be based on trade activity by a CCPs own trading venue thus avoiding de facto discrimination between trading platforms.

Additional comments on your consultation document.

Annex 1.

1 d. The product being electronically confirmed is described as a useful indicator of product standardisation. This is a weak argument as most/all trades are electronically confirmed in today's financial markets. A large part of today's OTC derivatives are already subject to regular trade reconciliation. An concrete example is the services provided by TriOptima (part of the ICAP group) where currently 5.5 million live trades (single counted) are reconciled, we estimate this accounts for 75% of all non-cleared OTC derivatives globally. This is only possible because of existing electronic capturing of existing contracts.

Annex 2.

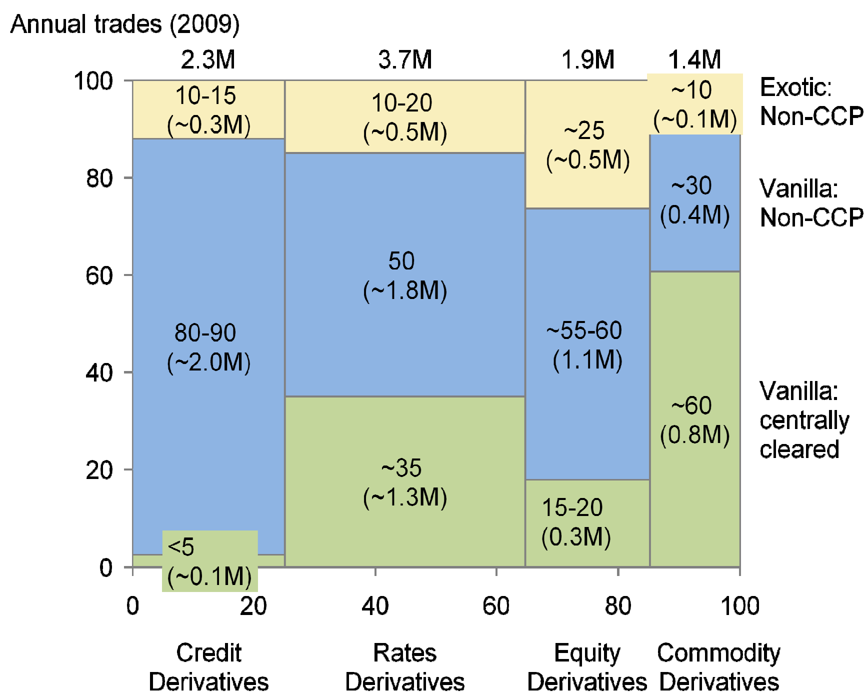
4. The role of CCPs in developing and adhering to industry standards and market protocols. " By definition DC members must adhere to the relevant ISDA protocols. Therefore CCPs participating in the DC process would also be bound by its decisions. It is further recommended that each CCP establishes an internal determinations committee ... in case the relevant market committee does not make a determination".

ICAP questions the wisdom if this paragraph as it could lead to severe market disruptions when one group of market participants have the opposite view of one or the other CCP. A market event will impact many different OTC derivative products as well as other products used in the financial market. This should not be left as an open item subject to interpretation, guidance should be crystal clear that in the event of a credit event all products and all DC have to come together.

Annex A- OTC volume eligible for CCP or bilateral clearing

- Some vanilla instruments have higher level of liquidity, accessible prices, and legally standardised contracts. Allows easy novation, valuation and collateral management by CCP.
- Other vanilla instruments have legally standardised contracts but may not be liquid or have easily accessible prices. Valuation and collateral management are handled bilaterally and can be automated.
- Exotic instruments are thinly traded, custom structured (no standardised contract), and difficult to price. Complexity and non-uniformity of instruments makes CCP clearing nearly impossible.

⇨ **% of volume eligible for CCP clearing expected to increase further in future due to decreasing appetite for bespoke products**



Source: ISDA, annual reports, interviews, literature search, BCG analysis