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Are new product ideas the result of customer demand?

The effect of OTC products coming into the ETD space

Where is innovation coming from?

Innovation in listed derivatives - where will it come from?

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Welcome to FOA InfoNet

It is commonly accepted that the biggest development affecting the industry at the moment is regulation. Wrapped up in that single word are a range of complex and challenging issues, which have resulted in an unprecedented degree of analysis and strategic planning as sell-side and buy-side alike, along with market infrastructures and vendors, struggle to assess how they will comply with the new rules and processes they are required to comply with.

An additional complication in this new world is the increasingly international impact of regulations that have, in many cases, been drafted from a national or regional point of view. The result is brokers in Europe keeping an eye on the impact of Dodd-Frank; Asian CCPs registering for recognition by the European regulator; and firms across the globe contemplating the impact of global capital requirements on their businesses, irrespective of where they are located.

It is in this climate that the FOA entered into its affiliation with the Futures Industry Association under the new structure FIA Global. FOA and FIA have enjoyed a strong and productive partnership over the last decade. But the significant reform efforts stemming from the financial crisis, and the increasingly global nature of the listed derivatives markets and how they are regulated led the two organisations to forge a more formal relationship to meet the global challenges ahead.

The combination of the FOA and FIA, along with its affiliate FIA Asia, will enable the associations to speak as one global voice, strengthening their influence on cross-border issues and substantially increasing the coordination and information flow between regions, while preserving each association's ability to deal with legislative, regulatory and market issues in its respective time-zone and maintain direct local connections with its members. This new structure will allow us to pool and target resources and expertise wherever in the world that our collective members require such help. It will also help us to align our policies and strategies to create operational and regulatory efficiencies for our common global members.

As part of this process, FOA will, in due course, change its name to FIA Europe. In the meantime, the two associations are already working more closely together on issues of cross-border significance. As the introductory brochure describing the formation of FIA Global puts it: The right time. The right organisation.

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A report on the 16th FOA InfoNet: Innovation in listed derivatives

Moderator

Jez Bezant, Independent buy-side consultant

Panellists

Brendan Bradley, Global Head of Innovation Management, Eurex
Simon Holmes, Product Head, i-Swap, ICAP
Ricky Maloney, Co-Head of Service Delivery, Ignis Asset Management
Robert Ray, Managing Director and CEO, CME Europe Limited
John Wilson, Global Head of OTC Clearing, Prime Clearing Services, Newedge

Jez Bezant This should be one of the easiest panels I'm ever going to do because it's about innovation, and if this panel are as innovative as they might say they are, they should do all the talking. I'll start with Bob Ray from CME. Bob, what really interests you about innovation in these markets?

Robert Ray I'm responsible for CME Europe, which is a new exchange that we're waiting to get through the regulatory process for recognition. We've been taking it slowly as you do when you start something from scratch and we've been working very well with the regulators here in terms of how to do it. We'll be starting out with 31 currency pairs, changing things quite significantly from the way we traded on the IMM for the last 40 years in Chicago. Then we'll look to push out other asset classes.

The idea is to wed it up with the new clearing house that we've opened in London, CME Clearing Europe, and then match up the listed futures with the swaps. We clear OTC interest rate swaps now and as we begin to push that out we'll have that all in the same pool. So from an innovation standpoint we're looking at reducing the capital requirements that are already out there and we'll do that with probably every asset class we move into. Doing lookalike competitive products brings very little value and we'd rather go where they aren't.

Brendan Bradley I suppose my new title [Global Head of Innovation Management] shows that there should be some attempt to look at innovation within the current mire of regulation.

We've had a change of structure within Deutsche Boerse. Andreas Preuss will now cover both the cash equities and the derivatives side. The title came about as part of that process and my background is very much product development biased anyway. So it's trying to add that background to what's happening with respect to market structure, and looking at where we can find some opportunities in all of this, as opposed to being worried about the regulatory issues that we all face.

Ricky Maloney I'm tasked with implementing the impact of OTC clearing into our business. I've spent the last two years working with sell-side banks and CCPs, reviewing their offerings and services and determining which ones we see as most fit for purpose. One thing that has concerned us greatly is the associated cost of clearing, with probably the 'collateral drag' at the far end of it, the most concerning. I've spent the last three to six months looking at alternative products that we could consider or that we could definitely do with in order to continue in particular lines of business.

We use a lot of total return swaps and, looking at the BCBS-IOSCO [Basel Committee for Banking Supervision-International Organisation of Securities Commissions] 15 per cent initial requirement, that's dead, so we've got to replace it. If we look at repos, financial transactions taxes are going to kill those eventually maybe, so where do we go? We're currently faced with a problem, we find a solution to it but six months down the road there's another problem that's going to destroy my solution. I'm very interested to hear what you guys are going to come up with. It's a learning process for me, I'm not here to teach. That's where the smart guys come in.

Simon Holmes The method of trading existing products is being forced to change and that's causing a huge spend. There are various different types of spend, some Ricky mentioned, but raw compliance dollars are just being spent on keeping an existing model alive and that's not really innovating anything.

I think we need to get through the extinction threat that incumbents face over the next six to nine months before people can start thinking what they can do to actually innovate with the structure that they've now got, assuming they have one. There could be something good coming out of this, but I don't think it's going to happen soon.

John Wilson I've spent the last four or more years in and around OTC clearing, trying to look at how we build these financial nuclear reactors at the far too rapid pace the regulators have been demanding, at the same time as being mindful of the cost pressures that this swathe of regulation is bringing and the market reform that's also being introduced.

To Simon's point, I'm already getting daily calls from prospective exchange venues asking to talk about trade certainty. The trouble is, they are talking about "five millisecond latency round tripping on your credit tokens" and co-location, and we have to explain to them that we are an OTC department. There are about 3,600 OTC swaps between the dealer banks a day. Globally, there are about 12,000 tickets written by everybody in OTC land for rates. So, one might ask what are talking about HFT for?

But that is the evolution that Simon referred to and with respect to innovation I believe it's all about margin discrimination. We have discriminatory levels of margin with different products and I would argue that much of what we're seeing now has got nothing to do with smart new ideas. It's just how do I re-label something to get cheaper margin? As an example of that, look at ICE who took their OTC energy swaps and called them a listed product. What happened? The liquidity didn't change, the process didn't change, the risk didn't change but the margin went down. How does that work?

I think FX is the most fascinating simply because the FX market has yet to wake up to the fact that it doesn't have mandatory clearing. While that may seem like a good thing, the BIS proposals call for 6per cent of the notional in initial margin for uncleared FX products. This should drive a look by FX players at how to get out of a bilateral position into a voluntarily cleared, perhaps OTC, product, or a swaps lookalike.

RR Brendan, you said that you've been asked to look at innovation that is not a direct result of regulation. That's one thing I wanted to explore because the point is that the rules are pushing the market down a certain route. Ricky, you're looking for solutions to help solve problems created by regulation or some capital issue that you might have in terms of margin. Is that real innovation?

"People are too short term. You've got to take a longer-term focus. You've got to make the investment, plant that flag and get on with it."
Robert Ray, CME Europe

RM I think it's the opposite of innovation, to be honest. We're now trying to innovate the industry in terms of trying to catch up with what the regulators have prescribed and that's a very difficult thing to do because the regulators perhaps don't fully understand the business we're in. We don't like the regulations, but somehow we've got to find some middle ground.

JB Simon, how far are we being pushed by the regulation and would we have got there anyway?

SH i-Swap is the brand of the company that was spun out of ICAP about three years ago to act as the electronic swaps trading solution for the market. It has some bank shareholders as well as ICAP. But the technology, the actual innovation started ten years ago and that was essentially because ICAP had the biggest market share and decided to spend a lot of money on building what some people thought was its own death warrant, but taking the view that if we didn't build it someone else would. ICAP would rather build the best one and at least have that option. That's an unusual step. You don't often see the incumbent building or promoting the next cycle of the business model.

The system went live in Europe two and a half years ago, admittedly after the G20 Pittsburgh declaration, but well before any kind of regulatory compulsion. It had a commercial logic behind going live. It had some

big banks and incumbents who wanted to see some change who thought there was a chance of innovation. That all happened without the CFTC holding a gun to anyone's head. What I'm hopefully going to be doing in the US later this year is purely in reaction to the regulators. There was no internal commercial pressure in the dollar market to do what the Euro market did. So, you have some genuine innovation that wasn't caused by the regulators contrasted with some slightly artificial forced change.

BB But was it the case, Simon, that the investment banks that supported your platform then saw the writing on the wall, so effectively they were trying to pre-empt what they saw coming down the track?

SH I did say it was after the G20 declaration but they didn't do it facing a hard deadline and they didn't do it after the Wall Street Reform and Consumer Protection Act. So they were anticipating a potential feature change rather than reacting to a known feature.

JW We know that Lehmans was a helpful catalyst to start people clearing voluntarily. There are people that had mandatory deadlines who have been happily clearing the OTC market for a long time, certainly in the OTC swaps market. They've been doing so to mitigate credit risk. Clearing is a very good credit tool, a good thing. The fact that the regulators now intend to discriminate through margin and induce behaviours that they're happier with is okay, but I think it's also had some interesting consequences.

The Fed, for example, helped the Treasury to come to a conclusion that these things didn't need to be cleared. They said the FX market's ours, so go away. It had a bit of a shock with the BIS proposals and is now encouraging CCPs to build clearing facilities for FX forwards, FX swaps, FX options even though it's not mandated.

JB Regulatory driven change should create opportunities for innovation because there are now people looking for solutions. Bob, you're doing a lot of things with your new venue. There are others that are doing the same thing. You must have a view about where this will create opportunities rather than unintended consequences which might pop up elsewhere.

JW Are you sure they're all unintended?

JB Well, it depends which MEP you talk to. Some of them are blissfully ignorant on some of this, but that said it is happening. We've got the listed market, which has been operating in a certain way and is now having to react to certain issues like the way margin is held.

So it goes back to two sorts of opportunities. Regulatory driven change creating genuine opportunities, which Ricky and Simon said they'd pre-empted, or people pre-empting change and coming out with genuine solutions that solve problems not created by regulation. So Bob, where do you think the opportunities might lie? If you were to think of a hot area for innovation that is a good news story, what would you say?

RR There are a lot of markets that are underserved. One of the reasons that we looked to set up a market over here is that we recognised, for example, that we were not really getting traction in Scandinavia, in Eastern Europe or Turkey or better traction on the Rupee. The issue is whether we either didn't market properly, or we're not closely aligned with the local end-users, dealing desks and banks. So that could be the corporations with relevant exposure or it could be second or third tier banks. We felt we really needed to get closer to those customers and take that a step further than the strategic relationships we had set up over the first five years of our experience internationally.

If you get outside of the G10 countries where everybody's trading the major contracts and look at Eastern Europe and the other areas, these are markets that are underserved from a price discovery and risk management standpoint. I would think a lot of people would love to be more actively involved in Turkey or Russia or any of those countries, but getting a credit line is pretty tough. So if you can provide an efficient way of solving those issues then you've got the ability to take care of the client, which ultimately is what everybody in the room should be doing, and secondly, doing it in an efficient manner so that that deal flow can continue for my fellow panellists.

JB So that's providing access outside of the well-served markets. And the same is true of the cash equities space.

RR Yes, people are too short term. You've got to take a longer-term focus. You've got to make the investment, plant that flag and get on with it. We're so analyst-driven and so short-term driven on revenue that we stick with those markets where you can get a quick hit on the revenue or on volume. It's a different story when you look at other developing markets. We learned a lot when we went into Brazil and partnered with BM&F-Bovespa and also in Mexico and Malaysia. We learned what it takes to really begin to start building

those markets. You need a different mindset all together when you go in there. Those markets are underserved, they're growing and we feel that's the place to be.

JB Simon, you mentioned that i-Swap has been a long time in the making, it was perhaps pioneering. You could do that because you had the funding at the time and it's only really come to fruition over the last three years. Where else do you see examples of that? What else could you point to?

SH I'm an interest rate swaps specialist I'm afraid so I can't add anything to what the panel would say about FX or energy or credit, but I think the potential exists. It's always been impossible for companies like mine to look beyond our own customers. There's never been any incentive to do so, but the regulator may force a more equal means of access, and in the initial phase the big users of derivatives, people like Ricky, would probably like to see their existing access to the market maintained. They'd like to see the product they currently use like total return swaps still available to them at the right price and still tradable. If it's not available, is there some corresponding benefit to the loss, like access to a different kind of liquidity? I don't think many big buy-side firms would even ask that question, because right now they're worried about keeping access to capital markets, but maybe later on they will ask that question, but I don't think there's an opportunity to do something yet.

JB You mentioned earlier that you think there's nothing really going to be happening now. We're all busily trying to meet the regulations and when it's settled down we'll see something emerging?

SH Well, all I can say is that everyone speculates about what's going to come and the extent to which we are going to be compelled to trade under SEF rules before the end of the year. I know how much we've been preparing for this and it still feels like a pretty short timeline. I find it hard to believe that anyone is relaxed about that and the imperative is to remain in your current business, not to make a land grab on day one for someone else's. If you could do that, that would be great, but the gap between the final set of rules and the first compulsion date is going to be too tight for anyone to do anything apart from simply trying to survive.

JW That poses some interesting challenges for firms like Ricky's because you've got no idea where the liquidity is going to go. So you might have, say, 42 SEF-like venues trying to talk to you about access into

> **"No one's going to stand up against the argument of lower barriers to entry and increased transparency. That creates more players."**
> **Simon Holmes, ICAP**

them, admittedly in different products. Then there are different CCPs. Who can predict where the open interest will go? So this is the dilemma for Ricky. He might have to make some bets because the likelihood of covering those 42 venues is slim. You might partner up with some banks, but all of that is replacing the system that you thought gave you an adequate view of the market.

RM Yes, exactly.

JW I'll give you an example from my former life. I took a set of officials from HM Treasury, the European Commission and the Council of Ministers and tried to show them the life cycle of the trade. So we went into an investment company and asked the dealing desk what it did. And they told us they get streaming prices from all the different banks so that they can see where the market is, and decide who they want to trade with. I said, "so you've got visibility, it's not a dark market?" They said, "no, we can absolutely see what's going on and nobody knows when we go into trade who we are." "Okay, so how about a lit market then? Are you in favour of everyone seeing your trades?" "Absolutely not, I'm very happy that everyone else's transparency is there but I don't want my trades shown."

So then we went into my old firm and they saw all the dealing desks. Then we went into ICAP and then we went into a clearing house. And there was just genuine surprise from those people. They seemed to see that the market works okay.

Some of the challenges ahead are the unknowns and

how you're going to manage that at a time when you've got a whole raft of regulations that you've got to keep a track of.

RM Such as Solvency 2 which encourages the use of more derivatives...

JW I know it's a more pessimistic outlook. At the moment it's more about survival but there is some innovation going on. Let me give you an example: one of the nightmares clearing brings in the current structure is we've got to keep moving collateral around. We get transit risk kicking in and questions about bankruptcy, etc. We ask ourselves why are we moving the assets about? This is nuts. Let's go and build a pledging system whereby you can place your assets into the CCP and the clearing member. We don't move them, we use instant substitution and so on. And that is now moving forward. It has solved some concerns around credit and transit risk etc. There's some innovation there and it's innovation in process.

JB And it's not regulatory driven. So we're painting a bit of a negative picture. If you're from the OTC world it's been negative for quite a while. If you're a fund manager you've got lots to comply with, if you're an IDB you're waiting for the rules and you've got to turn it around very quickly. Perhaps it's in other regions, more poorly served markets away from London where opportunities lie. So where else are we thinking about?

BB What I find interesting is that everybody's got to deal with that regulatory pressure, but what I hear here is that we're finding more efficient ways of using collateral than we used to. So are we being forced to do that? Isn't it a good thing that now there's a more efficient use of collateral?

Let's talk about product innovation, like dividend derivatives in the listed world. After Lehman, this was the first time we had a lot of hedge funds calling us and asking how they can tear up their OTC swaps and put them into an exchange clearing house environment. So suddenly from being a hedge fund and investment bank domain, you now have a huge number of traditional asset managers using the product so that, looking at what the size of that market was four or five years ago, we're now at least at 150 per cent, 200 per cent of what the market was.

Therefore, you bring new players and new liquidity in to the market place and I'd be surprised if you find a high frequency trader in there. There are people providing liquidity and they can use those products against existing listed products, whether it's the options products that are already there with people having dividend risk, etc. I think that changes things a lot.

SH No one's going to stand up against the argument of lower barriers to entry and increased transparency. That creates more players and brings in a new form of liquidity but at the same time I don't see why that won't happen in interest rate swaps in the fullness of time. It's certainly good for me as someone who's making a transaction-based fee.

But you'll also see some people cease to provide liquidity because they only used to provide it as part of a universal banking service. They were here for you in all these products and now they don't have to do it any more. They've lost the client-based nature of the relationship. They'll concentrate on the things that they make money on and if you're a big ticket user, you could find less liquidity available in the size you're looking for.

RM We will continue to have to manage risk, whether that's inflation or interest rate risk. We would be more than happy to use futures to manage that risk, even FX futures, but it will never quite match the risk profile of the assets we're hedging.

So do we look at a bilateral overlay and manage the additional margin costs? That's the basis risk we've got to cover. Do we leave the basis risk or do we cover it? Or do we get as close to it as we can using futures? Somebody needs to come up with a product that's going to fill that gap because I would happily use futures. It's operationally efficient, much more efficient in terms of margin. I would be there all day long, but it will not match out our current risk.

BB In the interest rate swaps and the CDS markets in particular all you hear is standardisation but there will be products available that won't be standardised and presumably they're the ones that will be more bespoke and won't necessarily have to be traded on SEFs. They won't trade ten times a day or whatever the requirement will be to have to put them onto a SEF, so therefore, there'll still be room for these types of products.

RM But they'll be the most expensive products, that's the trouble. At some point a hedge becomes unviable. 15 to 20 years ago I worked in a dealing room and a hedge was something you trimmed at the weekend. It was as simple as that. Obviously the industry's moved on but there comes a point when the value of a hedge falls out the window.

JB And there are firms like Ignis, which have been

able to create that business because you had access to the markets to hedge out those kind of risks efficiently through fully collateralised OTC products at no real risk to you, just what you'd normally expect from any collateralised relationship. But that's now been taken away from you or at least you'll be priced out of it.

So do we, therefore, need swap futures? It's the elephant in the room. Everyone has views on swap futures. But could they impact on what you're ultimately able to provide clients because a lot of the infrastructure is there to serve that investment need. Could people decide it's just not economically viable to use swap futures or any kind of future because of the basis risk and the cost of the hedging overlay? It's just going to get too expensive.

RM Yes, I could be really dramatic and say we're not making any money, we can't provide a service, let's withdraw and focus on our strengths. But, we're a pension fund manager essentially. We trade a lot of inflation, 25, 30, 40, 50 years out in some cases. We can't simply give back those pension fund assets and say we can't manage these anymore. We'll have to come up with a cost-efficient alternative, which will mean at the maturity of those pension pots, that there's some money in them that has not all been spent on hedging. My Gran doesn't care whether her pension is hedged or not. She just wants her pension.

JW It is said that to lobby the policymakers in Brussels, you've got to talk about pension pots being eroded, mortgages being more expensive or savings rates being dreadful. That's the only way to get the message across. Are these changes helping pension pots get bigger? However, against that is the credit risk aspect. It is costing more, but now you're paying an explicit risk premium rather than before when you just took the credit risk and dealt with it yourselves. That's the issue that we don't know the answer to yet.

I think Ricky and his peer group have got the new challenge of trying to work out what the cost of using these different types of instruments is and making the contrast between them. It is not as simple as saying, here's an off the peg suit and here is a made to measure one. They're not comparable.

And with respect to basis risk being an acceptable risk to take, the end customer hasn't got a clue really what you're doing on their behalf. That's why they've employed you to take that risk for them. I don't think that the toolsets exist to allow you to make really informed decisions to analyse that and to be familiar with them.

JB We also don't know the cost as well. It's not fully understood.

RR You're looking at a paid cost structure and comparing it to an unbundled transparent listed structure. How do you make that conversion? You're right, the tool hasn't been invented yet, but that's our markets, they're evolutionary. Go back to programme trading back in the 1980s and my biggest fear then and my biggest cost was through market impact, but by using these methods I'm under the radar and I'm achieving more. But the market evolved and took on a different form and you could say that HFT is just an offshoot of where that started from 30 years ago.

JW And the way the market developed in equities was to go into dark pools to avoid the market impact. That's why 40 per cent of the equity market is now in dark pools, which is paradoxical and not the regulatory intent for OTC.

JB So we're seeing this evolutionary step. A lot of people say we should look at the equity markets because they will provide good pointers as to where a lot of the other markets are going. Listed derivatives are very well understood. There isn't a need to have an exact match for any sort of liabilities. People are used to trading futures and rolling them every month or every three months.

Outside of that world if you talk about swap futures it becomes a bit of a step change for most people trading in those markets. What I'm hearing from the panel and from the market is that we're not there yet. So where do you think that sort of innovation is going to come from? Who will be the pioneers?

RM That's the real challenge for the sell-side banks and the CCPs. They can develop new products but they've got to give me liquidity. You've got the sell-side thinking that the new products might not be what we need, might not be fit for purpose. The sell-side can't just make stuff up. It sounds obvious but it's getting the right people together from the sell-side, the buy side and the service providers. You could take it forward from there because you could build the best product in the world but if nobody uses it, it won't work.

SH Swap futures have been tried a few times. That's a product that has some iteration.

JB Well, is it really innovative if it's been attempted before?

RR The markets are littered with really good

“For many years there was the OTC world and the listed world. Everybody knew their place and the two coexisted. Now that’s changing.”
Brendan Bradley, Eurex

contracts that failed because the timing wasn’t right. They just didn’t get any traction. We now have deliverable swap futures, a good product but are they going to set a standard? We don’t know yet. Things will evolve along with market needs.

BB But the new products have evolved, it’s not the same swap future each time around. One reason why they have evolved and improved is because the vested interests now perhaps recognise that they will have to support some of these products and so they may help a little more to make them more appropriate to the marketplace.

SH The thing that always seems slightly odd about swap futures is that if, say, you want interest rate delta and you’re trading euros, then you’ve got the Bund. I guess it behaves differently to a swap, but there isn’t a great need for something that gives you simple interest rate delta in the ten-year part of the curve if you’re a euro trader. In dollars it’s more complicated because a lot of the activity goes through the cash market, but I would certainly anticipate that the CME deliverable swap future will grow in volume.

Is it going to take some of the market that we currently make money out of? I suspect it’s going to take just as much out of the ten-year note future. Where this really would be effective would be somewhere that doesn’t already have a working unit of delta in the ten year. The Japanese ten-year bond future isn’t a great instrument and neither is the gilt future. I would have thought that deliverable swaps would be more potent where there isn’t that fully working alternative.

RR What you’ll see is a closer collaboration between different types of participant in the market because the market has arrived at a point where you need to put as much of the brain power together as possible. I’m responsible for an exchange but if it goes in for clearing or if it means it picks up deal flow for them and it satisfies what the end-user needs, you really don’t care because it’s one of those rising tide situations. It always works that way if you take that attitude. Participants are going to be working far more collaboratively. Listed exchanges are probably going to be sitting down with these guys and saying we’ve got an idea. We’re not sure that we can do this but we think you can. Let’s talk about how we can combine this and do it. That has to happen.

BB For many years there was a nice coexistence because you had the OTC world and you had the listed world. Everybody knew their place and the two coexisted and played off each other. Now that’s changing because there’s mandatory clearing and that leads towards the idea that you have to bring in some product that could be cleared and listed as well.

It may be that SEFs are the better environment for that and it may be that someone like ICAP is better positioned to put something like that together.

JW There has been some natural selection. One example I’ve used in the trading world is how the CDS index market simply got up from the IDB market over a couple of weeks in February, walked into Tradeweb and now over 90 per cent of that market is trading there. That’s because it suited the people who were doing it at the time.

That’s a natural Darwinian approach and I think people will abandon contracts quite quickly. But there will be a period of pain as the fragmentation takes place, whether that’s through the many CCPs we seem to have now or through the types of products that are out there such as Deliverable Swap Futures or lookalikes or futures. There are a lot of products coming through and figuring out where to go will be tougher.

Patrick Birley We’re meant to be talking about product innovation tonight and we’re talking about regulation being the driver. Forgive me, but where is the innovation in the derivatives market? Is there something coming from the leftfield because that’s what I’d really like to hear about.

JB That's a good point. The difficulty is that we're all struggling under this thick fog of regulatory stuff, none of which we really want. But what hopefully you'll have heard popping up a little bit are these different ways of doing things. These will change our markets and will turn out to be good things.

One of the key questions we've been moving towards is where does innovation come from? Ricky has given us this scenario where somebody's got to come and give him a solution. Bob was saying we need to go into a huddle and come up with solutions. But, is that the right approach? Are people like us that are part of the market possibly part of the problem because we're still doing the same thing? Or do we think that we're going to see changes to our markets not directly as a result of regulation but perhaps as a by-product of it? Is there somewhere else that we can see things coming from?

SH No doubt we'll have a burst of proper competitive change. It won't be this year, but when the rules are better known. For example, John's current firm and my own have never had anything to say to each other before. That's going to change dramatically and whereas before you've been part of the service provision network of CME and Eurex you're probably going to have customers who're going to want to do something with a toolkit that should only be accessible for big banks. There are all sorts of interesting things that will happen there. But I don't think we can expect to see it in Q3 and Q4 this year.

"If looking for 'leftfield' innovation you could ask what the futures industry has being doing for the last 25 years in terms of margin segregation."
Ricky Maloney, Ignis Asset Management

JB In a year's time, we might have more positive news but we have seen markets change. We've talked about CDS and we're still talking about swap futures. There's collateral management and the way the listed market works in terms of margin which are both sleepy kinds of worlds. Will those things change and will people have to wake up and ask if we could do this differently? Do we see smart people who've never really thought about our markets before coming forward to say this is a great opportunity?

RM If you're looking for 'leftfield' innovation you could ask what the futures industry has being doing for the last 25 years in terms of margin segregation. How is it that regulatory reform on the OTC side encourages as much segregation as you can practically afford in terms of operation and cost efficiency, yet you have had the MF Global scenario and other incidents and for over 25 years people have not realised that all of their cash is sat in this great big pool and it's an extreme risk.

RR I would say over the course of the next nine months or so that there'll be some very good product innovations, but a lot of it will be on the operational side, such as accepting gold as collateral. You'll see more third-party custodial accounts set up that further insulate the clearing house and the firm from the bankruptcy scenarios. That's where innovation will come from, driven by the operational side because the markets are too squeezed.

JW I would say that collateral trading will be the new thing because the squeeze in that space that will be driven by regulatory pressure. It will drive innovation around the trading of collateral and may well capture back some of the velocity that will be taken out of that market. I've done some work with a guy at the IMF in this area and looking at the velocity of collateral that is effectively part of the money supply and the concern that more assets are going to be immobilised at CCPs or at custodians so that more banks will have to hoard assets to meet the leverage coverage ratio. So you're going to have to get far smarter about how you do something with collateral. Collateral trading will be the thing.

Now we're seeing liquidity swaps where an insurance company holds some low yielding sovereign debt on its books which don't match its liability profile, and a bank holds a lot of retail and mortgage bank securities, which is completely illiquid. They make a deal to swap them and the fund manager takes a 60 basis point pick up on the trade and is happy with that.

RM We run a huge book of gilts and there's going to be a collateral squeeze. If you've got the ability to offer a transformational service, and we've got a repo desk, therefore we should do that.

JB So the role of the fund manager and the bank and liquidity provision is essentially reversing. It has been for big lending books for a while but not everyone's woken up to it. A lot of people outsource their lending to a custodian but often their service is not good. If you can be bothered to lend your own book you'd often make a lot more money than active managers.

So, roles are reversing. Is that the sort of thing we're going to see? We'll react to the market structure changes, but because banks aren't providing that inventory, that book, that liquidity, it now sits with funds, hedge funds, ex prop desk fund guys, big insurers like Ignis and others.

RM It could go as far as collateralised pooled vehicles which you would be able to invest in, a fund which is just a pool of collateral the value of which changes on a daily basis. Perhaps even a retail fund. It sounds a simple way to explain it but it's a possibility.

JW Innovation through agency lending and crossing of collateral is starting to come through. It may take us a long while to get there but there are examples, tangential to the swap market and listed futures.

JB Much of what we're talking about is slightly outside of listed derivatives because many people's view of the listed market is quite mature and there's not much else you can do. Swap futures is the nearest thing being considered that is going to impact that market and not everyone is convinced that that's the right thing for them and don't know how much impact they will have. But if you move away from all the contracts and I know we've got interest rate swaps, what other moves can we see? We've spoken about collateral. That will become very commoditised. Maybe it will end up in some sort of listed format or will it be that structured or will it operate in the dark for a while yet?

BB When you say listed, there's always this view that there's a central order book for it and, of course, as we've seen in the recent past there's a number of products that start as effectively block trade markets within the exchange, which then gradually build up to a sufficient size so that liquidity actually comes into the central order book alongside those blocks. The more you see business going into central clearing, the more there's going to be the ability to put the products that may have started as an IDB product in the past to potentially go directly into a listed environment.

But effectively, it's still a call around market for a given period of time until it builds sufficient liquidity. Actually some people may do that to get around SEF rules because they prefer to be in a situation where, whether it's because of margin or for some other reason, they have an easier block trade type environment than there might be in the OTC world and you can see more of that potentially coming through.

Talking about collateral, securities lending would be another area that I could see bringing in some innovation. It's probably about people trying to find ways of generating cash that they can use elsewhere. We certainly see the Eurex Repo, Clearstream and the OTC clearing guys talking to each other a lot more now than before and securities lending is another part of that.

JB I'm keen on learning about what people think they should or could be doing, rather than being forced to do it by the new regulations, which I think has been the theme so far.

BB What I'm trying to say is, it's a case of some of the high-level stuff being pushed in that direction, but around that people are saying there are other things they could do.

One thing we haven't mentioned is commodities. You mentioned earlier about less mature markets and maybe there are more opportunities in that space. Obviously trying to find new things in interest rate swaps is that much harder, but in the commodity space there should be plenty of opportunities. Whether it's coal, gas or power, they have some way to go and probably can borrow from things that have happened in more established markets.

Question from the audience I would like to ask about exchange fees and then wind that back into new products. There's so much more cost now that either the buy-side or the FCM will have to pick up. That might be because of the whole cost of regulation, the financial transaction tax or the unknown amount of trade repository reporting. Are the exchanges with new products going to be reflecting that and significantly building that price in to give much skinnier exchange fees to stimulate liquidity, so the FCMs don't have to eat it or pass it through to the buy-side?

BB Well, I'd have to claim that Eurex has always been a relatively cheap exchange and doesn't differentiate between buy-side and sell-side in terms of

its fees. At the same time, there are volume rebates and fee caps on certain products that facilitate certain types of transactions. For a long time we've been reducing fees and even in good times we've reduced volume thresholds for rebates, even for established products. So from that perspective we're doing our bit.

Question from the audience Everybody tells me that FCMs don't make money, how do you feel about that?

RM We seem to be very lucky right now. If a broker reduces a commission, everybody's happy to do that for us. That can only be because you guys are offering that to them, they wouldn't be doing it at a loss. So, obviously, it's the cheaper the better for the buy-side.

JW Over the last three years, OTC clearing shops have been opening up and haven't generated any revenue because mandated clearing dates kept slipping, so no-one felt the need to go to clearing. So some people have been carrying cost for some time and certainly the focus was pretty much for every dealer bank to focus on top bracket clients. For those big accounts there have been some cheap, below cost deals available. That can be because you're protecting your franchise.

Naively, perhaps, several years ago, people thought they needed to offer clearing to protect their execution franchise. That was without thinking of a scenario where clearing and trading could be completely split, so that your trading desk wouldn't know who's clearing the trade and your clearer wouldn't know who's done the trade. We're probably getting close to the point at which there is under capacity in the market.

Some capacity has also slipped away because fund managers have appointed two, three or more firms and in doing so have grabbed some of the capacity.

JB Going back to fees, are we expecting a little too much of each other? Maybe there's something around technology, something else that means you don't need or don't really have or can't have that extra service provision being handed out because there are too many people doing too many things outside of the very electronic world of cash equities and very liquid listed futures. You might think that's not quite innovation but it's something that's got to change and people will start thinking of different ways to do things.

JW I know that three of my main competitors have recently issued a circular to their clients saying that prices are going to have to start edging up. That's just a natural consequence. There's been a shakedown, intense competitive pressure.

"Three of my main competitors have recently issued a circular to their clients saying that prices are going to have to start edging up."
John Wilson, Newedge

In listed clearing everyone knows the price for the biggest clients is fractional, and at the other end there are a lot of clients now starting to get into what they call MAC (minimum account charges) because there is a cost to servicing a client and I'm facing, as my peer group are, on-boarding costs with CCPs who tell me that it's not free to get up and running in a particular product. There is effort involved, so costs are starting to come through.

JB So, coming back to the point we discussed earlier, extra costs will be passed on to end-users of derivatives like Ricky. It will be done in different ways but it will all come through. And at some point they'll be thinking that this is just too expensive. I can't charge my own customers this much. It's not efficient, I need something different. That should be a catalyst for innovation.

RM Yes, definitely. The CCP maintenance fee alone is enough to blow your socks off but obviously the banks need to make some money. We should remember though that there will be some cost savings on the bi-lateral side.

JB Does that mean you'll embrace futures, for example, or some other product?

RM Absolutely, yes. If you consider we've got £75 billion of assets under management, we're pretty much directional. The average duration of that book is probably 15, 20 years. So that's 15, 20 years of annual maintenance charges from the CCPs that will be charged on top of everything else. So yes, we've got to get away from that.

Question from the audience Ricky, you came up with three statements. Firstly, you said you trade futures in spades. Secondly, you said you do a lot of total return swaps and thirdly, you said your Gran likes to have inflation protected instruments. I'm assuming they're going to be 50-55-year inflation swap backed things. How many exchanges are coming to you with products that suit what you want to do in terms of trading futures in spades, coming to you with inflation products, or coming to you with a total return future, for example?

RM We've had one clearer talk to us about inflation products. It's almost like the school disco. Somebody needs to make the first move. It's about getting the right businesses together to talk about the issues and the potential solutions. If they match, go and build them. If not let's scrap it and think of something else.

JW That said, Patrick Pearson has repeatedly told the market it was not paying the social cost of using derivatives, etc. and that is now going to be rectified by regulation. So there's a deliberate intent to make life more expensive and the corollary to that is that pension pots will get smaller, unless we can find returns from new sources.

JB I'm not completely convinced that it's deliberate to make it more expensive. I think it's a deliberate move to make everything into more of an environment that suits certain people in other parts of Europe. The opportunity for us is to create solutions that reduce costs or impacts.

Question from the audience Bob, why isn't the swap product that CME has launched attracting liquidity? Brendan, Eurex re-launched the Euribor futures contract, not exactly an innovation, what are you doing in the swap futures space?

Ricky, you've talked about costs. Could you tell us how much more expensive you think a swap will be to put on in two years time against what is today or was three years ago? Is it a significant amount? And, Simon, could you cast your mind forward two years and tell us if you think you'll be trading most of the stuff you do today on a SEF or on the exchange?

RR The CME swaps product is doing really well. It's on a par with most new product start-ups. It's a new concept so it takes a little longer than, say, a plain vanilla FX contract to bring to market, to get multiple users in it who then need to figure out how to handle and trade it. We're very happy with it, to the extent that we're looking to expand it into different currencies. But it's a first generation product and while there are some products that were mistimed or weren't marketed properly, we think that the timing on this is good.

JB Brendan, you've been accused of not being innovative by re-launching Euribor futures.

BB We haven't actually re-launched, it's always been there. The innovation is in the new trading architecture and with that in place we have new approaches to help us work with the marketplace to build liquidity. And given that everybody else is having a go at it we might as well join in.

In terms of swap futures, we have two or three different specifications on the table and we're talking to market participants as to which one they prefer which, of course, differs depending on who you talk to. On the deliverable product, of course, there's also a question mark about whether the patent stands up in Europe versus the US. So that takes a little bit of time to work out. With respect to the rest, some of the demand for the product in the States came from some large buy-side customers and, sometimes buy-side customers in Europe are not quite so vocal in terms of ensuring that certain products actually get to where they should be.

RM That will change.

JB Ricky, you were asked to articulate the cost of trading swaps.

RM In terms of bilateral derivatives we're fully collateralised across all asset classes, but the big change is having initial margin for bilateral derivatives. We've got to meet that and the associated downstream costs. That leads to the opportunities mentioned earlier in collateral optimisation. That's something that everybody in the value chain has been looking at.

Taking FX, for example, we've probably got £12 billion on now and if I have to pay 6 per cent initial margin on that, that's £720 million that quite frankly we don't have. Looking at vanilla IRS the only changes are to the initial margin and associated costs. We could probably manage that appropriately, but it's the other products, TRSs, inflation, foreign exchange. It's going to kill that business for us. So, it's exponentially more expensive.

JB Simon, SEF versus listed, where will you be doing most business?

SH I think the two-year time horizon is too short to see where the open interest will actually reside. Currently, pre-SEFs in the IDB space, we see over three-quarters of the liquidity from our banking clients

coming in the form of structures rather than outright swaps and we've built our platform to excel in that particular space. We 'own' the liquidity there, to the extent that anyone does. We have good reason to expect to still have the majority of the more structured flow that comes from the IDBs. That may just be the banks protecting their own interests about where the open interest ultimately resides as well.

The much more interesting question is where new entrant flow, people who are not currently big users of swaps, will go. If we can take the fight to the futures exchanges on that, then that would be an achievement. The natural home for that won't be with us. So is that where the market will grow?

RR It sounds as if you're working together.

SH No, but it seems to me that a decent SEF has to preserve the market condition that it's being gifted with from day one. How can you compete for the new market? If you want a hard number I'm not going to give you one, but that's where the flexibility is, and if the exchanges comprehensively win the battle for new entrants then the battle for the existing open interest is on.

JW I think that everyone on this panel, with the exception of Ricky, will start to morph into something that looks just like each other. So I couldn't care less which product Ricky chooses to trade. I'll clear any of them because that's what we're building up to. CME won't care either because they'll clear all those products, as will Eurex, and they'll trade most of them. Simon and his peer group will probably all become Designated Contract Markets (DCMs) as well because under the regulatory discrimination you'll end up saying actually it's more convenient. It will then come down to innovation, price and the services around it. That probably will be the biggest change we're going to witness. We'll all be offering to do everything for everybody, but there'll probably be fewer of us because the number of MTFs in Europe is just ridiculous. Liquidity will probably gravitate to fewer venues, which will do more things.

SH John has just given us a great jumping off point. Michael Spencer made the point that if the five-day against one-day margin discrimination is going to continue to exist then he needs to be able to trade futures and will happily take on CME execution with a lookalike future. That's the key question that has to be resolved and how it is resolved is going to determine everything.

RM Just from a personal, selfish perspective we need to try and match our risks, ideally using easily accessible futures and to manage the gap risk as well somehow. The innovation out there in the minds of very smart people needs to come and knock on my door and tell me what's going on. I'm happy to help.

JB Brendan, what's on your list of things to look at which hopefully are a bit more positive than the regulatory driven stuff we've been talking about?

BB Apart from inflation and the other things already mentioned, commodities in general are still an area with room to grow into. And following on from what we've talked about on the financial side, some sort of credit/equity type product would seem to be the way forward. There are a lot of credit products that look a little like equity products or the other way around and there should be opportunities to see whether we can morph into some of those.

JB Bob, what would you say about innovation and how would you conclude your views on what you've heard tonight?

RR When you used the word 'listed' in your question earlier, that indicates you have an infrastructure but now you can do OTC through it so that adds to operational efficiency. We really need to leverage up that infrastructure and make it as efficient as possible in terms of fees and costs.

We shouldn't be immune to what market participants are going through in terms of having to adapt and making cutbacks because of being constantly driven to look at increasing profit margin. We're in the same position. We have to leverage up what we have, making it as efficient as we can.

You'll probably be lucky if 20 MTFs are still around in a year because it's not sustainable. You used to be able to put chips all over the table and make a play but you just don't have the resources anymore. You've got to be able to demonstrate a value proposition in order to attract those chips.

JB I know we got stuck in regulatory treacle but the 'take home' that I'll offer up now is that what we've been talking about is regulatory stimulated evolution rather than innovation.

If you want true innovation you probably need to put together a panel of 18 to 20 somethings sitting in their bedrooms programming apps to try and make their next million to see if they can come up with something to improve our market structure.

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FOA InfoNet: Three years on

David Setters takes a look back at some of the topics that have been up for discussion during InfoNet events and asks what changes might be in store for the industry in the near future

When FOA Infonet was launched in 2010 the aim was to gather together the best industry brains from brokerage firms, professional trading groups, exchanges, IT vendors and market users and put before them a range of issues to discuss.

Each annual series of meetings has been loosely divided up into four main headings; commercial and regulatory issues affecting businesses as a whole; operational/market infrastructure issues; trading and execution issues; innovation in products and services.

Given the post-financial crisis environment it's not surprising that the regulatory agenda has dominated the subject matter discussed at the meetings. And it's fair to say that while discussion on that agenda has been lively and often punctuated by the wit and wisdom of the panellists, the prevailing mood has often been negative, with many experts citing the lack of clarity of the outcome of the rulemaking as a major bane to the future prospects for their businesses.

The regulatory influence and indeed the mood have even extended to the sessions on innovation in the exchange traded derivatives business, sessions which are intended to be forward looking and tasked with asking where growth will come from for the industry. At the most recent FOA Infonet meeting (see report on pages 5-16) the conversation was unsurprisingly constantly brought back to innovation driven by regulatory change. Nevertheless, the intention is to push on with this topic area at future meetings.

It is almost impossible to believe that an industry which has been at the forefront of financial markets' innovation since the early 1980s will not come up with further advances as the new regulatory environment beds in.

"The regulatory influence has even extended to the sessions on innovation in the ETD business, sessions which are intended to be forward looking and tasked with asking where growth will come from for the industry."

Product, process and place

At our last event, panellists looked at three aspects of innovation; product, process and place.

In terms of product, we asked if there are prospects for any genuinely new asset classes or, for the time being, is it more about adding new improved processes to current asset classes, the chief of which at present might well be bringing OTC products into the cleared environment?

Some energy market specialists point out that cleared OTC products would have come about anyway because of commercial pressures, looking at what happened with ICE post-Enron and what happened to the freight market a few years ago.

But which really new product areas have succeeded over the past ten to 15 years? It would seem that probably only carbon and the Vix volatility index products at the CBOE have had some relatively modest success in terms of new 'families' of products.

It also has to be said that there has been some innovation in catastrophe insurance and weather in the past, while others are hopeful for environmental products more generally, volatility products in other areas and 'new' commodities like power, freight and iron ore etc.

Many of these products are currently traded in the OTC environment and although there are, as ever, vested interests in keeping them there, Clive Furness, Managing Director, Contango Markets Ltd suggested to one FOA InfoNet audience that forward thinking IDBs might partner with exchanges to bring OTC products which are moving towards standardisation into the ETD environment with revenues secured via some kind of licence agreement.

As we move on to process, we're certainly looking at capital efficiencies. The most recent example of this is NLX's new offering in the interest rate markets, although all the major exchange operating groups have initiatives seeking to smooth the efficient use of capital given the mandating of increased requirements and the feared shortage of appropriate collateral.

Is improved process still about going faster, the so called 'arms race' to zero latency? Or, as has been pointed out on several occasions, is it about being smarter with multi- or cross-asset offerings and enhanced straight-through processing? Perhaps, as has also been pointed out, there may be opportunities in process which will arise by embracing the new regulation and taking competitive advantage from it.

We've also heard at FOA InfoNet that technology can, of course, drive the market forward, but also that front and back office vendors can actually hold back the development of new exchanges and new products. Recent history has shown that if a new venue or a new product is not linked to the major front, middle and back office providers from day one, then the venue operators are up the proverbial creek, or may have had to pay an arm and a leg to get to the front of the queue for development.

Increased standardisation in the industry has also been cited by some, including Paul Marks, EMEA Head of Electronic Execution, Listed Derivatives Products, Citi as having the potential to be a significant catalyst for improved process. Marks suggested that there remain many areas for FCMs to compete in, but he strongly believed that areas like API, connectivity and data management could be handled in a better way so as to bring benefit to the industry as a whole.

New market mechanism?

There have also been suggestions that current new product development caters perhaps too much to the needs of the high-frequency trading business. Are trading venues getting the customer mix right? Are they perhaps alienating some traditional players? Mark Fox-Andrews, chairman of ADM, cited a physical commodity market hedger customer who felt he was losing out because he couldn't match his cash flows to the margin requirements in derivatives markets, especially in times of extreme volatility. Given this,

"Recent history has shown that if a new venue or a new product is not linked to the major front, middle and back office providers from day one, then the venue operators are up the proverbial creek."

Fox-Andrews also felt that it was possible that new players, perhaps from the insurance industry, might come up with some new market mechanism, but as yet there has not really been any progress in that area.

And moving finally to place, emerging and frontier markets have obviously been a topic of discussion. How can they compete against the major exchange groups? Or rather should they co-operate with them? Furness again sees efficiencies if people would only collaborate. Could major exchanges, for example, partner with emerging market exchanges, using them as incubators for new products? On the other hand, perhaps the large exchanges could license products to them. There is already the example of the CME licensing its Dow Jones index to the Sibiu exchange in Romania.

But it also occurs that the industry could learn from the new markets. And perhaps it will have to as China begins the slow process to internationalisation. It should be noted that some new products have been tried but have failed in established centres while they have been successful elsewhere. For example, steel, coke and coal, etc have been successful in China while listed FX has worked well in Brazil.

And yet another view is that new markets in the frontier territories might insist on their own model because they simply can't access established markets. Various attempts are now being made in Africa, for example, though results are expected to be slow to come through.

Finally, it seems to be a given that the big exchange groups will continue to look at taking market share from their competitors in the major contract families. And regarding that, you cannot avoid asking if it really is worth the time and effort and does it really provide the innovation the markets need?

It remains a big boy's game for now, but it will be interesting to see if the current upheaval in the marketplace provides the opportunity for new players to come in, potentially from a completely unseen source.

European trade reporting and the impact on the buy-side

By Daniel Jude, Director, Client Development & Sales – Asset Managers, CME Europe

In the aftermath of the financial crisis, there was acceptance among market participants, national authorities and global regulators of a requirement for improved risk management and increased transparency in the derivatives markets.

In 2009 the G20 met in Pittsburgh and agreed that all standardised OTC derivative contracts should be cleared through central counterparties, traded on an exchange or other organised venues and reported to trade repositories. The aim of this was to improve the OTC derivatives market with regards to risk reduction and transparency.

This approach was welcomed by regulators, but it was decided that the regulation should be the driving force in order to ensure compliance and success of such wholesale changes to the financial landscape. Global regulation is changing the molecular structure of the OTC derivatives market and much more dramatically than the G20 had envisaged.

The impact on the global financial markets industry could be compared to the Industrial Revolution of the 19th century. The regulations will impact each step of the trade life-cycle from execution, confirmation, settlement and reporting. Just like the Industrial Revolution, the transition will involve a move from manual operations to highly automated processes with an end goal of straight-through processing.

Some of this regulation roll-out is now in place and buy-side operations teams who were already being stretched attempting to streamline and improve their efficiency in bearish markets are now struggling to cope with the deluge of regulation. The buy-side community is now waking up to the operational complexities that regulatory reporting requirements are placing upon it.

As of 10 April 2013, regulatory reporting for all asset classes mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) has been taking place in the US. The European Securities and Markets Authority (ESMA) created under the European Markets Infrastructure Regulation (EMIR aka The Regulation) currently aims to introduce regulatory reporting in Europe on 12 February 2014 for OTC centrally cleared and OTC bi-lateral rates, credit, FX, commodities, options and exchange traded derivatives (ETD).

The inclusion of ETD caught the market off-guard and has become a major concern for all counterparties who trade these products, especially the buy-side. The question has been asked: “Why have ETD been included under the European mandate?” These products were not considered to be the cause of the financial crisis and the nature of the way in which they product is traded, ie on exchange, and the relative transparency appear to be in line with the G20 Pittsburgh summit objectives and that of EMIR for OTC derivatives.

Cause for concern

Operational complexity is exacerbated for the buy-side due to the nature of their structures, funds, investors, trading mandates, trading relationships and trading in multi-jurisdiction markets. The lack of extraterritoriality rules, agreement on equivalence and lack of client knowledge is a major cause of concern for the industry as a whole.

Reporting regulation in the US mandates single-sided reporting, based on a hierarchy to a swap data repository. EMIR regulation requires dual reporting ,i.e. both counterparties to the trade are obligated to report without duplication certain data to an authorised, approved and registered trade repository under EMIR.

Some buy-side firms are still either unaware of or not focusing on the regulatory reporting requirements. For some firms, this lack of attention is due to the fact they are more familiar with the single-sided mandate of the Dodd-Frank Act, which has left a large population of the buy-side community only indirectly impacted by the reporting requirement. These firms are now looking for clarity as they prepare for EMIR’s dual reporting requirements and seek clarity as they prepare to implement a short-term tactical solution, pending the development of a long-term strategic multi-jurisdiction compliant reporting solution.

Some buy-side firms have begun to look at their possible options and solutions to meet their reporting requirements. Others are still under the incorrect assumption that their executing brokers, clearing broker, clearing house, middleware will under-take the reporting for them. This is a major concern for regulators as the reporting date approaches.

Executing brokers, clearing brokers, clearing houses and middleware need to engage their clients, ensure that

"Finding a trade repository that can minimise the operational burden, and most importantly educate the buy-side community, will define the success of that trade repository and the trade repository landscape as a whole."

they are aware of their reporting requirement and not assume a third party is reporting on their behalf.

Some of the questions that are being asked which are useful in regards to ascertaining next steps:

- Who can assist me with ensuring compliance to the reporting requirement?
- What is the requirement – asset classes, LEI, UPI, UTI?
- EMIR allows for "delegation", what is delegation and can I benefit from this?
- My executing broker, clearing broker, clearing house, middleware (applicable only where appropriate) will be accepting delegation of the reporting requirement for me so I don't need to self-report?
- While some of the "counterparties" involved in the trade process may offer some solutions for reporting their trades, not all will have a solution. The client also must consider their bilateral trades (off exchange, non-cleared, not electronically confirmed, inter firm trades if applicable) and how they will report these.
- What are the criteria for selection of a trade repository? It is suggested that market participants need to select a trade repository based on numerous factors: coverage of asset class; technological capability – inbound and outbound consumption of data; cost; simplicity and ease of connectivity; and support and assistance.

These are only a few of the major questions that are being asked among industry participants.

There is a major shift in the market in regards to the relationship between repositories and buy-side clients. More and more clients are looking to self report and therefore contacting trade repositories and establishing direct relationships. This is a very significant difference as previously brokers, intermediaries and banks managed the relationships with the buy-side and then had the relationship with swap data repositories (this model still exists in the US with single-sided reporting) and trade repositories (nuances with current reporting entities).

Traditionally brokers, intermediaries and banks have connected to one trade repository or swap data repository, yet with the regulation offering freedom of choice to clients, this makes the support, assistance and level of service offered by a trade repository a major contributor in the client selection process. As client demand increases for a certain trade repository then the sell-side may need to react accordingly and connect to multiple trade repositories to appease client demands.

ESMA envisages around 12 authorised trade repositories under EMIR in the first year of mandatory reporting. Industry experts believe this number will decline over time as the trade repository landscape moves from infancy to adolescence. This is coupled with the view that trade repositories will be similar to the prime brokerage landscape over the past years, where clients may have limited loyalty to trade repositories and the initial trade repository selected will not necessarily be the long-term reporting repository of choice.

In truth, the landscape is evolving so dramatically and so quickly that information on the reporting requirement is continually changing. Finding a trade repository that can minimise the operational burden, and most importantly educate the buy-side community, will define the success of that trade repository and the trade repository landscape as a whole.

While there is still a need for more clarity in regards to the reporting requirement, especially in regards to third-country jurisdictions and equivalence of regulation, it is imperative that buy-side firms start to engage with trade repositories as soon as possible.

Resource constraints are a concern for all firms in the financial markets, especially with the requirement to re-focus key resources from core activities and system development to regulatory compliance. Trade repositories are conscious of learning lessons experienced by middleware providers as Category 2 Clearing under the DFA approached – they were inundated with requests for onboarding, set ups or enhancements from clients who at the 11th hour realised the impact on the regulation upon them.

Trade repositories are therefore using the remaining time available before EMIR reporting regulation comes into force to educate clients via webinars, meetings and presentations, with the key message being "engage early to avoid non-compliance with the regulation of your jurisdiction".

FOA news

FOA forms affiliation with FIA

This summer, the FOA membership approved the Association's affiliation with the Futures Industry Association (FIA) under one global structure called FIA Global. As part of this process, the FOA will be changing its name to FIA Europe in the coming months.

The confederation of FOA, FIA and its affiliate FIA Asia under FIA Global will enable the associations to strengthen their influence on cross-border issues, substantially increase the coordination and information flow between regions, and provide a powerful global voice to express the views of FOA and FIA members.

FOA chairman Steve Sparke said: "The Board is delighted that members have recognised the clear benefits of the affiliation with FIA, which will strengthen our capability to address what are increasingly global issues, while, critically, preserving the ability of the FOA to take the lead role in the European arena."

OPERATIONS

Letter on definition of financial instruments

August 2013 ~ FOA joined with the European Federation of Energy Traders (EFET), Global Financial Markets Association (GFMA) and ISDA in a letter to the European Commission, European Parliament and Lithuanian Presidency regarding the definition of financial instruments under MiFID II. The associations drew attention to the narrow definition in the current text, which inadvertently captures physical commodity transactions that do not have the characteristics of financial instruments. They proposed a wording that gives certainty to the intention of the parties regarding the physical settlement of contracts.

FOA Guidance for firms operating in the call around market

July 2013 ~ FOA has published guidance that is a non-exhaustive statement of some of the measures that FOA members may choose to adopt to evidence compliance with FCA requirements in relation to the practice of 'Payment for Order Flow' (PFOF).

Response to Ofgem consultation

July 2013 ~ FOA has responded to Ofgem's call for evidence regarding pricing benchmarks in gas and electricity markets.

Block trading guidance

June 2013 ~ the FOA has published a guidance paper on block trading and EFRP (Exchange of Futures for – or versus – a Related Position) negotiation, execution and documentation. The document is designed to identify the generic requirements for firms involved in the execution of EFRPs and block trades and highlights specifically what FOA deems to be good practice for these trade types.

Power trading update

June 2013 ~ The FOA's Power Trading Forum has been working on a project to shift the trading of UK physical forwards power from the current EFA calendar to the Gregorian calendar. Following extensive dialogue with the market on the most effective process for the transfer, the migration will take place on 1 November, for trades delivering in winter 2014. The move is seen as an important step in removing a key barrier to the development of the UK power market, by bringing the trading calendar in line with other European power markets and the gas market.

Futures For Kids Walk to Work

The third annual FFK Walk to Work took place on 13 September. The appalling weather conditions didn't stop around 80 hardy souls from the futures and FX communities in London trekking into the City from Essex, Kent and Surrey, distances ranging from 10-50 miles. Walkers included Charlotte Crosswell, CEO of NASDAQ OMX NLX; William Knottenbelt, Managing Director EMEA, CME Group; FFK chairman Bill Templer, FOA's own Emma Davey, and teams from SunGard, Trading Technologies, Eurex and Fidessa, as well as trading firm OSTC, and many other individuals. The walkers have so far raised over £65,000 for four fabulous charities; Demelza, Hope HIV, Everychild and Variety.

NEW FOA MEMBERS

We are pleased to welcome the following new members:

- Accenture
- BOCI Global Commodities Ltd
- DRS LLP
- Mercuria Energy Trading SA
- Traderight
- UnaVista
- Xtrakter

FOA events calendar

Future Compliance Forum dates 2013

- Thursday 31 October
- Thursday 28 November
- Thursday 12 December

Topics to be confirmed

FOA's Annual Power Trading Dinner 2013

Thursday 10 October ~ Sheraton Park Lane Hotel

Now in its 11th year, this black-tie dinner provides a valuable networking opportunity for members of the power and energy trading community.

NEW FOR 2013:

FOA's Clearing & Technology Gala Dinner 2013

Thursday 28 November ~
The Pavilion at The Tower of London

FOA is pleased to announce the inaugural Clearing & Technology Gala Dinner, which will incorporate the FOW's Clearing and Settlement Dinner.

The dinner will provide a valuable networking opportunity for the futures industry's' clearing, operation and technologies communities.

The evening will, additionally, provide a forum to raise funds for Futures for Kids.

Sponsorship opportunities and table reservations available for both FOA & non-FOA members.

THE NEXT INFONET

The commercial outlook for ETD businesses

January 2014 (date & venue TBC)

Senior management from FCMs, exchanges, clearing houses, proprietary trading firms, vendors and end-users discuss their latest issues

Who can attend?

This event is open to executives at FOA member firms and to invited guests of the FOA and InfoNet Sponsors.

For more information on all events, please contact Bernadette Connolly on connollyb@foa.co.uk or +44 20 7090 1334.

Thursday 28 November 2013
The Pavilion at The Tower of London

FOA FOW

Announcing **FOA's Clearing & Technology Dinner 2013**
incorporating **FOW's Clearing & Settlement Dinner**

New for 2013... do not miss your opportunity to join this evening of dinner, drinks and dancing and a key networking occasion for the futures industry's clearing, operations and technologies communities.

The evening offers a unique high-profile promotional platform for sponsorship opportunities, and a forum to raise funds for Futures for Kids (www.futuresforkids.org.uk), the industry's charity.

For further information, or to discuss sponsorship opportunities, please contact Bernadette Connolly on +44 (0)20 7090 1334 or email: connollyb@foa.co.uk

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