



34th Bùrgerstock Meeting - Thursday, September 26, 2013

The second day of the 34th FIA/SFOA Bùrgerstock Meeting started with a bit of fireworks from a rather unexpected source, a regulator. Scott O'Malia, Commissioner on the US Commodity Futures Trading Commission (CFTC) expressed frank self-criticism of the process of the new regulatory framework his organization is instituting. While its goals are lofty and perhaps laudable – among them a global and harmonized regulatory system, and elimination of regulatory arbitrage – the devil, as always, lies in the details. He wonders if the commission might not have gotten the order of things wrong and issued what could be seen as preemptive imperialist regulation, missing the opportunity for proper international negotiations on these important issues, and for other regulatory bodies to work directly with the CFTC. The processes have not been transparent enough. Dictating a one-size-fits-all solution will not yield regulatory harmony. He mentioned potentially delaying the October 2nd go-live of the notorious footnote 88 to allow for a smooth transition. The compliance date should be adjusted to afford market participants more time to study the rulebook to ensure consistency and legal compliance. There simply has not been enough time to report the data consistently and the CTFS cannot afford to implement what is actually an arbitrary date. Swap-execution facilities (SEFs) are racing to meet this deadline, but do not yet have the necessary technology set up to meet the new data-reporting and other requirements. Commissioner O'Malia is concerned that the deadline may negatively impact liquidity, especially in overseas markets. At the same time, he stressed that the CTFS is not the global regulator and that cooperation is necessary on an international level to avoid regulatory imperialism.

The morning's first panel discussion, entitled "The challenges of global clearing", set the tone for the day by continuing the regulatory topics set into play by Commissioner O'Malia. Moderated aptly by Steve Plestis, Head of Marketing, Prime Derivatives Clearing, EMEA, Credit Suisse Securities, the session set out to cover how different regulatory regimes are impacting the agendas of global clearing houses. Mr. Plestis illustrated this point with a hilarious speech consisting nearly exclusively of industry and regulatory acronyms, before turning the discussion over to a panel of clearing house executives. Tina Hasenpusch, Managing Director & Chief Operating

Officer, Clearing Solutions, CME Clearing Europe, noted that her company is meeting the deadlines in a process of continuous engagement. Her European organization has the advantage of being used to regulatory flexibility and is accustomed to dealing with different account structures. The clearing house members will ultimately determine what risk they are willing to bear. She advocated de-cluttering the cost element. Costs should be less like a sausage in which ingredients are mixed opaquely and more like a salad in which the individual ingredients are visible. On the topic of interoperability, Paul Swann, President & Managing Director, ICE Clear Europe, pointed out that market forces will dictate what will and will not happen. He cautioned against excessive interoperability and noted the advent of the risk of multiple failures through connected systems. In terms of costs, he feels clearing houses may need to graduate costs depending on the level of protection. They must generate sufficient revenue to ensure that the system remains safe. He foresees an approaching period of consolidation in a world that is growing tougher.

Michael Walinskas, Executive Vice President & Chief Risk Officer at OCC, spoke of costs and how OCC has conducted a cost/benefit analysis of clearing. He pointed out that it is not possible to lower costs in this new ramped up regulatory environment. There are still too many principles that remain undefined, too many unknowns exist. The subjective issues of regulation must be dealt with reasonably. He sees clearing houses as being on the forefront of this fight.

Bernie Kennedy, Head of Business Development at LME Clear, opined that building a new clearing house, as her company is doing, may have advantages over existing CCPs. Perhaps with a blank piece of paper they might just do things a bit better. She sees benefits arising from the new regulatory environment from the client perspective in the form of improved disclosure and transparency. Complexity drives innovation. She envisions a competitive edge going forward as the environment matures. "We're new, and we're out there to advance".

Gavin Wells, Chief Executive Officer, ForexClear, LCH. Clearnet, mentioned that in the US, the market appreciates any efforts taken that can harmonize the regulatory framework. He feels that all CCPs should come to market in one fell swoop. But before that can happen, there are practical issues to be settled, such as a lack of clarity re-

garding KYC (know your client) and perhaps even to need to KYCC (know your client's client). It is also essential to pay attention to just how these new structures are to work commercially. There is an appropriate cost for clearing, a fair price to pay.

Markus Zickwolff, Senior Advisor for Eurex, said that changes in the macro structure are driving a change in behavior. We must improve communication with customers. A CCP-integrated offer is important to clients, who are watching to see how things develop. Efficiency is important, but must be combined with integrity. We must explain the cost burden to customers in order to avoid customer flight.

After listening to the panelists, it is clear that the various regulatory regimes are indeed impacting the agendas of global clearing houses.

The panel discussion was followed by a one-on-one discussion with Phupinder Gill, Chief Executive Officer of CME Group, who was interviewed by Paul Davis of Noble Group, in a session one audience member humorously called 'grill Gill'. Mr. Gill provided insights into the state of affairs in Asia, where some countries are far along the path of implementing the new regulatory regime, while others lag behind. He stressed the need for a more enlightened outcome-based approach over proceeding line by line. He is concerned about unnecessary additional costs, which will ultimately be bad for the industry.

In regard to China, Mr. Gill views it as an essential part of the global landscape. While its borders may be closed now, once they open, benchmarks owned by some entities may come under pressure. He also spoke of Brazil with its current internal focus as it grapples with structural issues, and India where he sees a need for the regulatory environment to further develop.

The new SEF arrangement is in line with CME Group's strategy, though much remains to be sorted out. After consolidating their US operations, they are now expanding into Europe with the aim of creating an interconnected world from a client standpoint. He cautioned, however, that forced interoperability may perversely kill innovation.

Walt Lukken, President & CEO of the Futures Industry Association next interviewed Jaques Aigrain, Chairman of LCH.Clearnet Group. He played down the challenges presented by the changing regulations by saying that it's quite pleasant to be in a growing industry. Mr. Aigrain feels that the horizontal remains viable and still has room to develop. We must work on facilitating solutions for the user in terms of efficiencies. It's an ongoing process with the regulators to find the right balance. He views mutual recognition as the true solution from a practical standpoint, but doesn't see it happening in his lifetime. He praised the clarity and jurisprudence of US law, which has proven itself, while European law remains a patchwork.

Following the lunch break, hosted by Cinnober, the first afternoon panel session was a continuation of this year's underlying regulatory theme, entitled, 'International Regulatory Reform.' It was moderated by Jacqueline Mesa, Senior Vice President & Director of International Relations and Strategy for the Futures Industry Association, who asked the panelist to assess the progress of G20 reforms around the world.

David Bailey, Head, Market Infrastructure & Policy, Financial Conduct Authority, sees progress as generally good, but warned that unless the G20 agenda is implemented on a local level, we risk the danger of undoing all the good we have done. Moving down the road we must take care to keep moving forwards, not backwards.

Rodrigo Buenaventura, Head of Markets Division, European Securities and Markets Authority (ESMA), said that at his organization the focus is on equivalence of regulations. They try to foster clarity by providing answers that apply across the entire EU. He sees the timing as doable, in a process in which the principles are converted to EU law one year before they impact the big players, allowing sufficient time to fix standards. While ESMA is abiding with the letter of the agreement, Mr. Buenaventura made the case for an outcome-based assessment on a role-by-role basis with detailed comparison, chapter by chapter, area by area. Europe and the US may have different rules, but the outcomes are the same.

Masamichi Kono, Vice Commissioner for International Affairs, for the Financial Services Agency, pointed out that Japan was the first country to meet the G20 commitment, but has done so flexibly to leave room for international coordination, in a cautious approach as the new regulatory environment remains a work in progress. Pro-international standards, he would like to see compliance substituted with regulatory equivalence.

Scott O'Malia was asked directly whether the SEFs would go live in October or not, and answered by saying that the industry might as well plan for. However, he also mentioned ongoing problems with data and the need for soup to nuts testing of SEFs before going live. Right now there are 15 registered SEFs with 15 different rulebooks. The concept of pre-trade credit checks is not feasible in its current form. The requirements must be clarified. These issues, along with the registration of US persons bear the risk of participants placing trades back on the bilateral market, which would lead to unpredictable liquidity issues. In terms of substituted compliance, Mr. O'Malia would look for transparency in the process. The CTFS is analyzing how foreign jurisdictions match up with US Dodd-Frank rules. It is too soon to know whether the rules that are ultimately made will be granular or outcome-based. He repeated that it makes more sense to do it right, than to stick to some arbitrary date. While the CFTC is largely complete, now that it's done they have to go back and fix it.

A concurrent session was held, entitled “The Cost of Clearing” moderated by Michael Varian, Managing Director, Head of Agency Derivatives Services at Barclays. The panel consisting of top clearing firms and Europe’s largest buy-side firms - APG Asset Management and Brevan Howard - came to grips with one of the most challenging issues facing the industry: the substantial increase in clearing costs for both clients and clearers. The discussion focused in particular on the cost of clearing swaps. The money managers on the panel set out their reasons for demanding a level of collateral segregation as safe as the bilateral world, while the clearers countered that the cost to provide that level of protection would further reduce the already depressed level of profitability in the provision of clearing. The number of global clearers has fallen to less than a dozen and almost certainly will consolidate further, leading to a new source of systemic risk, they warned. But one ray of light beckons - the panel discussed the potential for innovation in clearinghouse design so that more buy-side firms can join as members.

The next panel session on “Innovation and Competition among Trading Venues” again had a regulatory focus as executives from four exchanges discussed how they are positioning to grow their businesses in the new regulatory environment. It was moderated by Mike du Plessis, Managing Director, Global Co-Head, ETD Execution Services at UBS. He noted the perception that the effect of reform is to provide a tailwind for change and that the sheer scale in reform in the market in a sub-optimal amount of time tends to support the incumbents, which is an unintended consequence.

Robert Ray, Chief Executive Officer, CME Europe, sees the current environment as a great opportunity to bring his company’s value proposition to the market. They are focusing on where others do not have the market covered. In this proliferation of new markets and products, end-users need to be more selective about their preferred platform. He believes in letting to the private sector choose how it wants to do business, rather than mandating that choice.

Sunil Hirani, Founder & Chief Executive Officer, trueEX, a regulated exchange, questioned whether the so-called regulatory tailwind might not effectively be a headwind that is requiring some heavy lifting among market participants. The market is very competitive, offering plenty of choice and an abundance of alternative venues for futures. A young exchange like his must come up with a differentiated offering that is not yet available in the marketplace. They must start with lower-tier firms and only approach the top-ranked after they have gained some traction. He pointed out that only 2% of new products succeed. It’s a

constant convincing job.

Charlotte Crosswell, Chief Executive Officer, NASDAQ QMX NLX, also a new exchange, is also looking to do something different, offering margin offsets to attract customers and provide greater choice in clearing. The challenge with the horizontal model is that CCP development may not happen fast enough. One conundrum is that it is difficult to get backing for new products, while at the same time, such backing is essential for innovation.

At the concurrent session, entitled “Deploying Algos for Order Execution”, a panel of experts from different sectors of the industry led by Greg Wood of Deutsche Bank Securities provided their insights on the application and evolution of algorithmic trading in the futures and options markets. The panelists discussed the diffusion of algo techniques and technologies over time and across an ever-wider range of markets and market participants. They emphasized, however, that users of these trading tools need to understand the precise characteristics of each market and adapt their algos accordingly. As one participant, Jonathan Field, formerly of Man Group, commented, algorithms are evolving from relatively inflexible “Robocop” methods to more sophisticated “Iron Man” methods that amplify human skills and expertise rather than simply replacing them.

The final panel session of the day was entitled, “Cross-Border Reach of Dodd-Frank”, continuing the regulatory theme that is all pervasive at this year’s meeting. It was chaired by John Hughes, Managing Director, EMEA Head of Regulatory Strategy for Banking & Markets, Bank of America Merrill Lynch.

Sarah Josephson, Director, Office of International Affairs at the Commodities Futures Trading Commission (CTFC) provided a clear summary of where we’ve been, where we are and where we are going as industry in terms of CTFC regulation. She views the phased implementation as flexible and diplomat. In terms of overseas cooperation, she referred to the final communiqué from the recent G20 St. Petersburg summit, which stated: In this context, we agree that jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulations and enforcement regimes, based on essentially identical outcomes, in a non-discriminatory way, paying due respect to home country regulation regimes.

George Harrington, Global Head, Fixed Income Trading at Bloomberg, said that the general view is that SEFs are ready to go. While that applies to Bloomberg, he is concerned that a large portion of the market will not be ready for trading on October 2nd. There are, however, other

options for trading, so he expects volume to drop after that date. He also sees a problem with liquidity. Half of liquidity providers are in the US. If you split that liquidity, as will be the case in Europe, you won't reach the necessary volume, making it on the whole a poorer situation. In addition, being a SEF is in and of itself not a revenue-generating business model.

Susan Ervin, Partner at Davis, Polk & Wardwell provided a legal perspective. Footnote 88 really pulled the rug out from beneath the multilateral trading facilities (MTFs), which must now rush to comply in order to keep trading. One result is that non-US MTFs are forcing out US participants to avoid the registration requirement. She would prefer to see cross-border guidance rather than set rules that are open to some interpretation. Yet, she remains optimistic that the rough edges will be shorn off to forge a path forward toward harmonization between the US and the EU.

Fabien Caruzzo, Associate at Kramer Levin Naftalis & Frankel, when asked whether clients really know what all the new regulation means, said that yes, buy-side participants have had a few years to observe the developments. He sees them being forced on to the SEFs with very little time to document compliance. There remain unsettled issues, such as the question of breakage costs. This is driving end-users to seek ways to insulate themselves from Dodd-Frank and look for ways to avoid it; an approach that he warns is a misperception. All this is driving an approaching wave of consolidation and a fragmentation of liquidity.

Thomas Erickson, Vice President, Director of Legal Affairs, Bunge Product Lines, sees Dodd-Frank as having both an immediate impact as well as down the line as participants scramble to deal with the complexity, which acts as a disincentive to the market. Life is already different, particularly when it comes to the distinction between being a full US person, a US person with a guarantee or a non-US person, which shall determine whether the participant is subject to Dodd-Frank or not. However, any company that wants to be a global player is faced with little choice but to comply. It tends to leave end-users standing like deer caught in the headlines as they struggle to deal with the regulatory onslaught.

Mr. Hughes went on to speak about the regionalization of trading moving forward and the end of the global trading model as a result of Dodd-Frank. This will have cost implications, making it expensive to trade in some regions. It is a watershed moment for the industry.

After a long but productive day of discussions, attendees spent the evening at The Café Restaurant du Parc des Bastions, a historic setting in the heart of Geneva. The restaurant is located on the site of military fortifications that date to the sixteenth and seventeenth centuries. In honor of this history, the attendees were welcomed to the dinner by Les Vieux Grenadiers, a military company that was founded in 1749 and distinguished itself during the Napoleonic era in the defense of the city of Geneva. The company, dressed in full uniform and under the command of its Vice Commandant Robert Frey, formed a "haie d'honneur" through which the attendees entered the restaurant. The members of the company then demonstrated their military skills by loading their rifles and firing a volley in honor of the occasion. Many thanks to the Geneva Financial Center for sponsoring this extraordinary event and giving our attendees a vivid glimpse into the authentic history of Geneva.

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