General Overview of the Dodd Frank Financial Regulation of Derivatives: Implementation, Progress and the Key differences between USA and European Legislation

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LOAN
5 year loan
Loan Amount = $100 million

Bank

$100 million Loan

Borrower

Interest Pmt (LIBOR Rate)

Dealer

Fixed 10 %

Variable LIBOR Rate

SWAP
5 year term
Notional Amount = $100 mill
LIBOR Rate = 8%

Bank

8 % Interest (LIBOR)

Loan

Borrower

8 % Variable (LIBOR)

Net 2%

Net Swap Payment

Dealer

Fixed 10 %
**LOAN**

LIBOR Rate = 12%

Bank

12% Interest (LIBOR)

Loan

**Borrower**

12% Variable (LIBOR)

Fixed 10%

**Dealer**

Net 2%

Net swap payment

**SWAP**

Notional Amount = $100 million

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Two Global Derivative Markets

- **Over-the-Counter**
  - Beginnings – 1981
  - Customized
  - No Clearing
  - No Exchange Trading
  - No Reporting

- **Exchange Traded**
  - Beginnings – Late 1800s
  - Standardized
  - Cleared
  - Exchange Traded
  - Reporting
Global Volume – Dec 2013
(Bank for International Settlements - Statistics)

• US$710 trillion notional outstanding
• US$18.6 trillion gross mark-to-market (FMV)
• US$3 Trillion gross credit exposure
• ISDA – 800 members - 64 countries
• JP Morgan – 18,000 active customers
“G19” Dealers
19 Dealers control 90% of Global Notional
(each has thousands of customers)
Dealer Concentration
(United Airlines Daily Flights)
Call to Reform Global OTC Derivatives

(1) Prevent systemic risk
(2) Transparency - Pricing
(3) Trade Reporting – Who trades
(4) Prevent market abuses
G20 Country Commitments - 2009

- **Clearing Trades** – Clearinghouses or CCP
- **Trade Execution** – Exchanges trading
  - Trading Platforms, SEFs & Trading Venues
- **Reporting** – swap data repositories
- **Bilateral** Non-cleared trades
  - More Collateral
  - More Capital
• Monitors G20 Country Progress


• http://www.financialstabilityboard.org/publications/r_140408.pdf
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G20 Statutes Effective – Blue is Good
Progress on “mandatory” Clearing

• Voluntary Clearing
• CFTC Mandatory 2012
• Partially effective
• Interest Rate Products
• Indexed Credit Deriv’s
• Exceptions

• Voluntary Clearing
• EMSA Proposal 10/2014
• Partially effective -2014
• Interest Rate Deriv’s
• Exceptions
Difficulties for Mandatory Clearing

• New Everything
  – New relationships (need a clearing member)
  – New documentation
  – New software, operations, procedures, etc.
• Clearinghouse Preparation & Safety
• Increased amount of collateral
  – Initial Margin
  – Full Variation Margin
Progress “mandatory” Trade Execution
“Exchange Trading” or SEF

- Voluntary exists
- Mandatory - 2/2014
- Partially effective
- “Swap Execution Facility”
- Products:
  - Interest Rate Derivatives
  - Indexed Credit Derivatives
- Exceptions

- Voluntary exists
- Rules in Process
- 2015+
- “Trading Venue”
  - Regulated market
  - MTF
- Exceptions
Difficulties
Mandatory Trade Execution

• New Everything
• Approval of “Exchange” or “SEF” or “Trading Venue”
• Product Approval – what can safely be exchange traded?
• Liquidity for each individual product?
Progress Trade Reporting

- Mandatory - 2013
- “Swap Data Repository”
- CFTC Approved
  - BSDR LLC
  - CME
  - DTCC-DDR
  - ICE Trade Vault
  - INFX SDR

- Mandatory - 2014
- “Trade Repository”
- ESMA Approved
  - CME European TR
  - DTCC-DDRL
  - ICE Trade Vault Europe
  - UnaVista
Difficulties for Trade Reporting

- EU – Difficulty in aggregating data
- Too many repositories - Over G20 countries
  - 11 jurisdictions reporting
  - 25 repositories
- EU - No uniform standards for trade reporting
Difficulties for Trade Reporting

• Bank secrecy rules – General G20 problem
  – prevent reporting
  – Prevent sharing cross border

• Enforcement Issues
Progress – Increased Bilateral Collateral

- 2013 IOSCO Framework
- Initial and Variation
- Proposed Rules – 9/2014
- Extended Implementation

- 2013 IOSCO Framework
- Initial and Variation
- Rules in Process
- Extended Implementation
Difficulties
Mandatory Bilateral Collateral

• Initial Margin – How Much?
• More Variation Margin – How to calculate?
• “Eligible Collateral” Problems
Summary

• G20 Statutes are in place
• Devil is in the Details - Rules
• Low Hanging Fruit
  – Progress on Interest Rate Derivatives
  – Trade reporting
• Cross-Border Problems